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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, [redacted] 1961

No. [redacted] 60

GROVER D. TURNBOW, ET AL., PETITIONERS,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

PETITION FOR CERTIORARI FILED MARCH 2, 1961
CERTIORARI GRANTED MAY 15, 1961

No. 16775

United States
Court of Appeals
for the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

GROVER D. TURNBOW and RUTH H. TURNBOW,
Respondents.

Transcript of Record

Petition to Review a Decision of The Tax Court of the United States

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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Tax Court of the United States

Docket No. 69429

GROVER D. TURNBOW and RUTH H. TURNBOW, husband & wife, Petitioners.

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

DOCKET ENTRIES

1957

Aug. 19—Petition Filed: Fee Paid 8/19/57. Served Sept. 5, 1957.

Oct. 23—Answer by resp. filed. Served Oct. 29, 1957.

Oct. 23—Request by resp. for trial at San Francisco, California. Granted 10/24/57.

1958

Jan. 16—Motion by petr. for further and better statement.

Jan. 16—Motion by petr. for severance of an issue and a preliminary hearing on the issue.

Jan. 23—Notice of hearing Feb. 5, 1958, Wash. D. C. on petrs. motions of 1/16/58. Served Jan. 23, 1958.

Feb. 5—Hearing on petrs. motions for further and better statement and for severance of issues.

1958

Feb. 5—Order, that the motion for severance of issues is Denied and further, Order, that the hearing for further and better statements is continued to March 12, 1958, Wash. D. C., to permit Resp. to file amended answer. Served Feb. 10, 1958.

Feb. 10—Transcript of Proceedings, filed.

Feb. 21—Order, that Order of the Court of 2-5-58 is vacated and set aside and further Order, that petrs. motions for better statement and severance of issues are Denied.

June 27—Notice of Trial Oct. 6, 1958, San Francisco, Calif.

Oct. 10—Trial before J. Harron—San Francisco, California.
Stipulation of Facts filed at trial;
Original briefs due December 9, 1958
Reply briefs due January 9, 1959
Submitted to J. Harron—Under Submission.

Oct. 24—Transcript of Proceedings 10-10-58 filed.

Dec. 3—Motion by resp. for extension of time to file brief to Dec. 29, 1958, Granted, 12-5-58, Dates of briefs, P&R, due 12-29-58, Reply Briefs due 1/30/59, M. J. Harron, Judge.

Dec. 5—Brief for Petr filed. Served 1-13-59.

Dec. 29—Motion by resp. for extension to Jan. 12, 1959 to file brief. Granted 1-2-59.

1959

Jan. 12—Brief by resp. filed. Served 1-13-59.

1959

Jan. 30—Reply Brief filed by petr. Served Feb. 19, 1959.

June 12—Findings of Fact and Opinion filed Judge Harron. Served June 12, 1959. Decision will be entered under Rule 50.

July 10—Motion by resp. for extension of time to August 12, 1959 to file Motion for reconsideration. Granted 7-13-59. Served July 16, 1959.

Aug. 12—Motion by resp. for review by the full court. Denied 8-13-59. Served Aug. 14, 1959.

Aug. 12—Motion by resp. for reconsideration. Denied 8/17/59. Served Aug. 17, 1959.

Aug. 12—Memo. Brief by resp. in support of resp's motion for reconsideration. Served Aug. 14, 1959.

Aug. 27—Agreed Comp. Filed.

Aug. 31—Decision entered, Judge Harron. Served Sept. 1, 1959. Appellate Proceedings.

Nov. 18—Petition For Review by U.S.C.A. 9th Cir. filed by resp.

Dec. 14—Motion for extension of time to file record on rev. and docket pet. for rev. filed by resp.

Dec. 14—Order enlarging time for filing record on rev. and docketing pet. for rev. to Feb. 16, 1960. Served Dec. 15, 1959.

Dec. 15—Proof of Service of pet. for rev. on counsel filed.

Dec. 15—Proof of Service of pet. for rev. on petrs. filed.

1960

Jan. 29—Designation For Contents of Record On Rev., with proof of service thereon, filed by resp.

[Title of Tax Court and Cause.]

PETITION

The above named Petitioners hereby petition the above entitled Court for a redetermination of Respondent's determinations of items of alleged additional tax liability set forth in Respondent's notice of deficiency, dated May 28, 1957, and as the basis for their petition allege as follows:

1. Petitioners are Grover D. Turnbow and Ruth H. Turnbow, husband and wife, and their principal office is at No. 425 Battery Street, San Francisco, California, and their tax returns for the period in controversy (their taxable years ended December 31, 1952 and December 31, 1953) were filed in the office of the District Director of Internal Revenue at San Francisco, California.

2. The notice of deficiency (a copy of which is hereunto annexed) on which this Petition is based, was mailed to Petitioners on May 28, 1957.

3. The amount of the alleged deficiencies determined by Respondent are as follows:

Year	Nature of Tax	Amount
1952	Income Tax	$264,037.43
1953	Income Tax	14,786.26
		$278,823.69

4. The following is an assignment of each and every error which Petitioners are able to allege to have been committed by Respondent in the determinations of the aforesaid alleged deficiencies:

(a) None of the several determinations of items of alleged additional tax liability specified in the notice of deficiency is predicated on any basis in fact or in law which are or have been disclosed to Petitioners; and:

(i) said notice of deficiency denies Petitioners due process of law, as guaranteed to them by the Fifth Amendment to the United States Constitution; and

(ii) each of said determinations is violative of the principles set forth in Respondent's own regulation (C.F.R. Internal Revenue—1954, § 601.106 (f)(1)) that "an exaction by the United States Government which is not based on law, statutory or otherwise, is a taking of property without due process of law in violation of the Fifth Amendment to the United States Constitution" and that conclusions of fact and application of the law "shall hew to the law and the recognized standards of legal construction"; and

(iii) said notice of deficiency fails to comply with the standard declared by the Supreme Court of the United States in Helvering v. Tex-Penn Oil Co.,

300 U. S. 481, 498, that a taxpayer is entitled to know the basis of law and fact on which the Commissioner seeks to sustain his deficiencies; and

(iv) since the purpose of this proceeding is to enable this Court to redetermine the determinations made by Respondent, the failure of the notice of deficiency to disclose any bases in law or in fact for Respondent's determinations leaves this Court without any assistance from Respondent's said notice of deficiency in knowing, or considering, or evaluating the bases in law or in fact, if any, upon which Respondent's determinations are made; and

(v) since Petitioners have not been informed by Respondent in said deficiency notice or otherwise of any basis in law or in fact for Respondent's determinations, they are unable in this Petition either to set forth, or point out, specific errors in whatever bases in law or fact may have existed for Respondent's determinations; and

(vi) by reason of the premises aforesaid, each of said determinations of items of alleged additional tax liability is void for uncertainty.

(b) (i) Referring to Respondent's determination for 1952 of alleged additional income—"(b) net long term capital gain—$495,754.01": Respondent erred, in computing and determining and recognizing Petitioners' gain from their exchange in 1952 of their 5,000 shares of International Dairy Supply Co., a corporation, for 82,375 shares of capital stock of Foremost Dairies, Inc. plus $3,000,000 in cash, in

the sum of $4,163,691.94 and in failing and refusing to determine that, but for the receipt by Petitioners, in said exchange, of cash "boot" in said sum of $3,000,000,

—such exchange would have constituted a "reorganization" as defined by 1939 IRC §112(g)(1)(B); and

—no gain would have been recognized from such exchange under the provisions of 1939 IRC §112(b)(3); and

(ii) Respondent erred in valuing the Foremost stock at $15.00 per share; and

(iii) Respondent erred in failing to determine that but for the receipt by Petitioners in said exchange of said cash "boot" in the sum of $3,000,000 said exchange would be within the provisions of 1939 IRC §112(b)(3) and under 1939 IRC §112(c)(1) and that Petitioners' gain from such exchange should be recognized, in an amount not in excess of said $3,000,000 cash "boot"; and

(iv) Respondent erred in his recognition and computation of "Gain Recognized — $4,163,691.94" (which such amount is in excess of the amount of said cash "boot" received by Petitioners in said exchange); and

(v) Respondent erred in his computation and determination of "Additional Gain Recognized—$1,178,699.17" and in his "Adjustment to Income—50%—$589,349.59".

(c) Referring to Respondent's disallowance of the item "(c) Legal Fees—$1,148.66": Respondent erred

in disallowing said item of legal fees paid subsequent to the exchange of Petitioners' stock in International Dairy Supply Co. for stock of Foremost Dairies, Inc., plus cash, for advice and counsel respecting Petitioners' income tax liability for 1952, with respect to their gains resulting from such exchange and to assist them in reporting such gains for income tax purposes.

(d) Referring to the year 1953 and the item "Unallowable Deduction"—"(a)Depreciation on dam—$2,312.11": If the rate of "depreciation allowable 2%" means that Respondent determined that the economically useful life of the earthen dam is 50 years, Respondent erred in determining that said earthen dam had an economically useful life in excess of 20 years and in determining that the rate of depreciation thereof was 2%.

(e) Referring to the year 1953 and to the item "Unallowable Deductions"—"(d) Legal Fees—$1,500.00": Respondent erred in disallowing this item of expense which was paid by Petitioners for legal counsel and advice with respect to Petitioners' income tax liability for 1952 and to assist them in reporting their gains for 1952 for income tax purposes.

5. Following are the facts upon which Petitioners rely as sustaining the foregoing assignments of error:

(a) (i) Respondent has failed to specify any bases in law or in fact for his several determinations of alleged items of additional tax liability of Petitioners for said calendar years 1952 and 1953 and

denies Petitioners due process of law in this,—that Respondent has not advised Petitioners of the bases in law and in fact upon which Respondent made his determinations of alleged items of additional tax liability and Petitioners do not know upon what bases in law or in fact, if any, said determinations of items of alleged additional tax liability may have been made, and it is therefore impossible for Petitioners in this Petition to comply with the Court's Rule which requires them in this Petition to set forth clear and concise assignment of each and every error committed by Respondent in the determinations of alleged items of deficiency.

(ii) Respondent's determinations of items of alleged tax deficiency for each of said taxable years is void for uncertainty for failing to state any bases in law or in fact for any of said determinations.

(b) (i) In 1952 Petitioners were the owners of all (viz. 5,000 shares) of the issued and outstanding shares of voting capital stock of all classes of International Dairy Supply Co., a corporation, hereinafter called International.

(ii) In 1952, Petitioners exchanged their said 5,000 shares of International with Foremost Dairies, Inc., a corporation, hereinafter called Foremost, for 82,375 shares of the voting capital stock of Foremost plus cash "boot" in the sum of $3,000,000.

(iii) Said exchange between Petitioners and Foremost was made under and pursuant to a plan of reorganization.

(iv) In said exchange, Foremost acquired all of

the issued and outstanding shares of the capital stock of all classes of International.

(v) But for the payment by Foremost to Petitioners, and their receipt, of said cash "boot" in the sum of $3,000,000 in said exchange, said exchange would have been an exchange of Petitioners' said voting stock in International solely for said voting stock of Foremost, and Foremost, in said exchange, would have acquired all of the issued and outstanding shares of the voting capital stock of International solely in exchange for said 82,375 shares of Foremost's voting stock.

(vi) The fair market value of the Foremost stock received by Petitioners, on the day the exchange was consummated, was $14.50 per share.

(vii) Petitioners' recognizable gain upon said exchange was $2,984,992.77.

(c) In 1953 Petitioners were and they are now the owners of Pomponio Ranch situated in San Mateo County, California. In 1953, in order to conserve and utilize for irrigation purposes rain waters on said ranch, Petitioners constructed an earthen dam with which to impound said water. Said dam impounds the headwater of Pomponio Creek for a drainage area of approximately 300 acres and has a storage capacity of approximately 265 acre feet. Said ranch and the dam site and the area in the rear thereof lies in the midst of steep hilly land, close to the Pacific Ocean, in an area of high rainfall and the soil in said ranch over which rain water impounded behind said dam drains and flows is a residual (silty-loam) type and lies atop clay, bedrock and shale and disintegrates rapidly

when impregnated with water and said soil has a very high erosive index. That by reason of the facts, the area behind said dam will become silted up, which will render said dam economically useless in a period not exceeding 20 years and the economically useful life of said dam will not exceed 20 years.

(d) In 1952, and after the consummation of the exchange referred to in the preceding paragraph (b)(2), Petitioners paid legal fees in the sum of $1,148.66 for legal counsel and advice with respect to the taxability of their gain from such exchange and to assist them in reporting said gain for tax purposes.

(e) In 1953 Petitioners paid legal fees in the sum of $1,500.00 for legal advice and counsel with respect to their tax liabilities on account of gains derived from their business transactions in 1952 and to assist them in reporting said gains for tax purposes.

Wherefore, Petitioners pray that this Court shall redetermine Petitioners' tax liability for said two years and

(a) Determine that Respondent's determinations of items of alleged additional tax liability for each of 1952 and 1953 were void for uncertainty in that each such determination denied Petitioners due process of law in failing to state any bases in fact or in law for any of such determinations.

(b) Determine that but for the receipt by Petitioners of $3,000,000 in cash "boot" in Petitioners'

exchange of their 5,000 shares of International for 82,375 shares of Foremost

(i) No gain or loss would have been recognized from said exchange under 1939 IRC §112(b)(3);

(ii) Said exchange would constitute "a reorganization" as defined by 1939 IRC §112(g)(1)(B);

(iii) Said exchange would be within the provisions of said §112(b)(3) if it were not for the fact that Petitioners, in said exchange, in addition to said 82,375 shares of Foremost received from Foremost said cash "boot" of $3,000,000;

(iv) Determine that Petitioners' gain from said exchange should be recognized in an amount not exceeding such cash "boot", viz. in a sum not in excess of $2,984,992.77.

(c) Determine that Respondent erred in disallowing the item "(c) Legal Fees—$1,148.66" for 1952.

(d) Determine that the economically useful life of the earthen dam on Pomponio Ranch was twenty (20) years and that proper rate for the depreciation thereof is 5%.

(e) Determine that Respondent erred in disallowing the item "(d) Legal Fees—$1,500.00" for 1953.

(f) Grant Petitioners such other and further relief as shall be meet and proper in the premises.

Dated: August 13, 1957.

/s/ M. W. DOBRZENSKY,
/s/ S. H. DOBRZENSKY,
Attorneys for Petitioners.

Duly Verified.

Form 1230 (App.)

U. S. Treasury Department
Internal Revenue Service
Regional Commissioner

Appellate Division—San Francisco Region
San Francisco 2, California

In Replying Refer to
Ap:SF:AA:MHB
90-D:CWB

May 28, 1957

Mr. Grover D. Turnbow and
Mrs. Ruth H. Turnbow
Husband and Wife
425 Battery Street
San Francisco, California

Dear Mr. and Mrs. Turnbow:

You are advised that the determination of your income tax liability for the taxable year(s) ended December 31, 1952 and December 31, 1953 discloses a deficiency or deficiencies of $278,823.69, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days from the date of the mailing of this letter you may file a petition with The Tax Court of the United States, at its principal address, Washington 4, D. C., for a redetermination of the deficiency. In counting the 90 days you

may not exclude any day unless the 90th day is a Saturday, Sunday, or legal holiday in the District of Columbia in which event that day is not counted as the 90th day. Otherwise Saturdays, Sundays, and legal holidays are to be counted in computing the 90-day period.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Assistant Regional Commissioner, Appellate, Room 1010, 870 Market Street, San Francisco 2. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after receipt of the form, or on the date of assessment, or on the date of payment, whichever is the earlier.

Very truly yours,

RUSSELL C. HARRINGTON
Commissioner,

By .....
Special Assistant
Appellate Division

Enclosures:

Statement
IRS Pub. 160
Agreement Form
SF - 4130

Ap:SF:AA:MHB
90-D:CWB

STATEMENT

Mr. Grover D. Turnbow and
Mrs. Ruth H. Turnbow
Husband and Wife
125 Battery Street
San Francisco, California

Tax Liability for the Taxable Years Ended December 31, 1952, and December 31, 1953.

Year		Deficiency
1952	Income Tax	$264,037.13
1953	Income Tax	14,786.26
Total		$278,823.69

In making this determination of your income tax liability, careful consideration has been given to your protest dated November 19, 1956, and to the statements made at the conference held on February 19, 1957.

A copy of this letter and statement has been mailed to your representatives, Mr. M. W. Dobrzensky, 1516 First Western Bank Building, Oakland 12, California and Mr. H. E. Alber, c/o Arthur Young and Co., 120 Montgomery Street, San Francisco, California, in accordance with the authority contained in the power of attorney executed by you.

Adjustments to Income
Year: 1952

Net income as disclosed by return		$1,610,718.16
Unallowable deductions and additional income:		
(a) Loss from business	$ 16,710.15	
(b) Net long-term capital gain	495,754.01	
(c) Legal fees	1,148.66	513,613.12
Net income as adjusted		$2,124,391.28

Explanation of Adjustments

(a) Your reported income is increased $16,710.15, representing the total of unallowable depreciation and expenses, as shown below:

Explanation of Adjustments—(Continued)

Pomponio Ranch:		
Legal expense	$ 312.49	
Repairs	2,800.00	
Depreciation	6,400.35	$ 9,512.84
Bakersfield Ranch:		
Depreciation		7,227.61
Total unallowable deductions		$ 16,740.45

(b) 1. In 1952 you exchanged 5,000 shares of International Dairy Supply Company capital stock for $3,000,000.00 in cash and 82,375 shares of capital stock of Foremost Dairies, Inc. You determined that the gain to be recognized was limited to the amount of cash received. In your return you reported a gain of $2,984,992.77 ($3,000,000.00 less $15,007.23 expense of exchange). It is held that the entire gain realized upon the exchange constituted taxable income. The adjustment to the income reported in your return is computed as follows:

Amount received on exchange:		
Cash		$3,000,000.00
82,375 shares of Foremost Dairies, Inc. valued at $15.00 a share		1,235,625.00
Total received		$4,235,625.00
Less: Basis of stock exchanged	$50,000.00	
Expenses per return	20,981.80	
*Add'l legal fees allowed	951.26	71,933.06
Gain recognized		$4,163,691.94
Gain reported		2,984,992.77
Additional gain recognized		$1,178,699.17
Adjustment to income—50%		$ 589,349.59

* 2. In your return you claimed a deduction in the amount of $1,148.56 for legal fees. It is held that these fees were not ordinary and necessary expenses incurred in connection with your business, but were expenses incurred in connection with the exchanges of stock. The deduction claimed is, accordingly, disallowed, and $951.26, the amount allocable to the exchange of your stock in International Dairy Supply Company, is allowed as a deduction in computing the gain on the exchange.

3. In your return you reported long-term capital gain in the amount of $189,786.00 from the sale of 13,100 shares of capital stock of Foremost Dairies, Inc. In computing the gain reported on the sale you used $6,795.00 as the basis of 10,000 shares and $2,718.00 as the basis of 3,100 shares, or a total basis of $9,513.00. In computing the gain on the exchange of your stock of International Dairy Supply Company for cash and stock of Foremost Dairies, Inc., the stock of Foremost Dairies was valued at $15.00 a share.

In conformity with the value used in computing the gain on the exchange $15.00 a share is allowed as the basis for determining the gain realized from the sale of Foremost Dairies, Inc. As a result of this adjustment, the capital gain reported on the sale of Foremost Dairies, Inc., stock is decreased by $186,987.00, as computed below:

Basis of 13,100 shares at $15.00 a share	$ 196,500.00
Less: Basis claimed in return	9,513.00
Decrease in capital gain reported	$ 186,987.00
Decrease in taxable income—50%	$ 93,493.50

4. It is determined that you are entitled to a capital loss carryover, after limitation, in the amount of $208.77 instead of $106.69, as shown in your return. Your reported net gain is, accordingly, reduced $102.08.

The adjustments shown as (b) 1. through 4. result in a net increase in your reported long-term capital gain in the amount of $495,754.01.

(c) This adjustment has been previously explained in paragraph (b) 2.

Computation of Tax
Year: 1952

Net income as adjusted	$2,124,391.28
Less: Exemptions	1,200.00
Income subject to tax	$2,123,191.28
One-half of such income	$1,061,595.64
Less: One-half of excess of net long-term capital gain over net short-term capital loss	1,049,466.07

Computation of Tax—(Continued)

Balance subject to tax		$ 12,129.57
Tax on $12,129.57		$ 3,858.19
Partial tax—$3,858.19 times 2		$ 7,716.38
Add: 104 percent of $1,049,466.07		1,091,444.71
Income tax liability		$1,099,161.09
Liability disclosed by return:		
Original Account No. BR 701100		835,123.66
Deficiency		$ 264,037.43

Adjustments to Income
Year: 1953

Net income as disclosed by return		$ 77,375.15
Unallowable deductions and additional income:		
(a) Depreciation on dam	$ 2,312.11	
(b) Loss from business	19,041.52	
(c) Taxes	400.00	
(d) Legal fees	1,500.00	$ 23,253.63
Total		$ 100,628.78
Nontaxable income and additional deductions:		
(e) Net long-term capital gain		2,438.24
Net income as adjusted		$ 98,190.54

Explanation of Adjustments

(a) In your return you claimed a deduction of $2,890 for depreciation on an earthen dam completed in 1953 at a cost of $57,828.57. It is held that 2% a year is a reasonable allowance for depreciation on the dam. The income reported in your return is adjusted as follows:

Depreciation claimed	$ 2,890.40
Depreciation allowable 2% of $57,828.57 for 6 months	578.29
Depreciation disallowed	$ 2,312.11

(b) Your reported income is increased $19,041.52, representing the total of unallowable depreciation and expenses, as shown below:

Explanation of Adjustments—(Continued)

Pomponio Ranch:		
Repairs	$ 6,492.96	
Depreciation	6,289.43	$ 12,782.39
Bakersfield Ranch:		
Depreciation		6,259.13
Total unallowable deductions		$ 19,041.52

(c) It is determined that the allowable deduction from real estate taxes assessed by the City of Piedmont, California is $1,357.30 instead of $1,757.30 as claimed in your return. Your reported income is, accordingly, increased $400.00.

(d) In your return you claimed a deduction of $1,500.00 for legal fees. It is held that these fees were not ordinary and necessary expenses incurred in connection with your business, but were expenses incurred in connection with the exchanges of stock. The deduction claimed is, accordingly, disallowed, and $1,242.33, the amount allocable to taxable exchanges, is allowed as a deduction in computing your capital gain for the taxable year.

(e) 1. It is determined that sales within the year of two cotton pickers resulted in a total net long-term capital gain of $1,097.71 instead of $2,914.78 as shown in your return. Your reported gain is, therefore, reduced $1,817.07.

2. As stated in paragraph (d), above, $1,242.33 ($621.17 after limitation) of legal fees paid is allocable to taxable exchanges and is allowed as a deduction in the computation of net long-term capital gain.

The total of these adjustments reduces your reported net long-term capital gain in the amount of $2,438.24.

Computation of Tax
Year: 1953

Net income as adjusted		$ 98,190.54
Less: Exemption		1,200.00
Income subject to tax		$ 96,990.54
One-half of such income		$ 48,495.27
Less: One-half of excess of net long-term capital gain over net short-term capital loss		6,952.96

Computation of Tax—(Continued)

Balance subject to tax	$	41,542.31
Tax on $41,542.31	$	22,646.46
Partial tax—$22,646.46 times 2	$	45,292.92
Add: 104 percent of $6,952.96		7,231.08
Income tax liability	$	52,524.00
Liability disclosed by return:		
Original account No. AC 163		37,737.74
Deficiency	$	14,786.26

Served and Entered September 5, 1957.

[Endorsed]: T.C.U.S. Filed August 19, 1957.

[Title of Tax Court and Cause.]

ANSWER

The Respondent, in answer to the petition filed in the above-entitled proceeding, admits and denies as follows:

1, 2, and 3. Admits the allegations in paragraphs 1, 2, and 3.

4. Denies that the Commissioner erred in the determination of the deficiency as alleged in paragraph 4 and in each and every subparagraph and subdivision thereunder.

5. (a)(i) and (ii) Denies the allegations in subparagraphs (a)(i) and (ii) of paragraph 5.

(b)(i) and (ii) Admits the allegations in subparagraphs (b)(i) and (ii) of paragraph 5.

(b)(iii) Denies the allegations in subparagraphs (b)(iii) of paragraph 5.

(b)(iv) Admits the allegations in subparagraphs (b)(iv) of paragraph 5.

(b)(v),(vi), and (vii) Denies the allegations in subparagraphs (b)(v),(vi), and (vii) of paragraph 5.

(c) Admits the first sentence of subparagraph (c) of paragraph 5; for lack of information, denies the remaining allegations.

(d) Admits that in 1952, and after the consummation of the exchange referred to in the preceding paragraph (b)(2), petitioners paid legal fees in the sum of $1,148.66 for legal counsel; denies the remaining allegations in subparagraph (d) of paragraph 5.

(e) Admits that in 1953 petitioners paid legal fees in the sum of $1,500.00 for legal advice and counsel; denies the remaining allegations in subparagraph (e) of paragraph 5.

6. Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that the Commissioner's determination in all respects be approved and the appeal denied.

/s/ NELSON P. ROSE, JM
Chief Counsel, Internal
Revenue Service.

Of Counsel: Melvin L. Sears, Regional Counsel, Nat F. Richardson, Attorney, Internal Revenue Service, 1069 Flood Building, San Francisco 2, Calif.

Served and Entered October 29, 1957.

[Endorsed]: T.C.U.S. Filed October 23, 1957.

[Title of Tax Court and Cause.]

STIPULATION OF FACTS

It Is Hereby Stipulated and Agreed by and between the Commissioner of Internal Revenue and the above named taxpayer, by and through their respective attorneys, that the following facts should be taken as true, provided, however, that this stipulation does not waive the right of either party to introduce other evidence not at variance with the facts herein stipulated, or to object to the introduction in evidence of any such facts on the grounds of immateriality or irrelevancy:

1. Petitioners are Grover D. Turnbow and Ruth H. Turnbow, husband and wife, and their prin-

cipal office is at No. 425 Battery Street, San Francisco, California, and their tax returns for the period in controversy (their taxable years ended December 31, 1952 and December 31, 1953) were filed in the office of the District Director of Internal Revenue at San Francisco, California.

2. The notice of deficiency was mailed to Petitioners on May 28, 1957. A true copy of said notice is annexed to Petitioners' Petition in these proceedings and the same is incorporated in this Stipulation, by this reference, as if set out fully at length herein.

3. The amount of the alleged deficiencies determined by Respondent are as follows:

Year	Nature of Tax	Amount
1952	Income Tax	$261,037.43
1953	Income Tax	11,786.26
		$278,823.69

4. The items "(c) Legal Fees—$1,148.66," disallowed for the year 1952, and the item "(d) Legal Fees—$1,500.00," disallowed for the year 1953, each represent items of expense paid by Petitioners for legal counsel and advice with respect to Petitioners' income tax liability for 1952 and to assist them in reporting such gains for income tax purposes.

5. In 1952 Petitioners were the owners of all (viz., 5,000 shares) of the issued and outstanding shares of voting capital stock of all classes of International Dairy Supply Co., a corporation, hereinafter called International.

6. In 1952, Petitioners exchanged their said 5,000 shares of International with Foremost Dairies, Inc., a corporation hereinafter called Foremost, for 82,375 shares of the voting capital stock of Foremost plus cash "boot" in the sum of $3,000,000, less the expenses of such transfer in the sum of $15,007.23, so that Petitioners received, as said "boot" the net sum of $2,984,992.77.

7. Prior to the time of said exchange of shares and cash, Petitioners, International Dairy Supply Co. and Foremost Dairies, Inc. had executed an agreement, entitled "Amendatory Agreement," bearing date of February 11, 1952, a true copy of which agreement is marked Exhibit I, annexed hereto, and by this reference incorporated in this Stipulation as if set out fully at length herein. Said Amendatory Agreement provides for the exchange by Petitioners of their said 5,000 shares of International with Foremost, for 82,375 shares of the capital stock of Foremost plus cash "boot" in the amount hereinabove referred to.

8. The exchange provided for in said agreement was consummated on March 3, 1952.

9. In said exchange, Foremost acquired all of the issued and outstanding shares of the capital stock of all classes of International.

10. In said exchange, Petitioners acquired only said shares of Foremost and said cash "boot" and Foremost acquired only all of the issued and outstanding shares of the voting capital stock of International.

11. Said 82,375 shares of the capital stock of Foremost, on the date of the consummation of said exchange, had a fair market value of $15.00 per share.

12. The economic, useful life of the earthen dam situated on Petitioners' Pomponio Ranch in San Mateo County, California, completed on December 31, 1952, is 40 years.

Dated: October 10, 1958.

/s/ M. W. DOBRZENSKY,
/s/ S. H. DOBRZENSKY,
Attorneys for Petitioners.

/s/ ARCH M. CANTRALL, CMN
Chief Counsel,
Attorneys for Respondent.

[Endorsed]: T.C.U.S. Filed October 10, 1958.

[Title of Tax Court and Cause.]

TRANSCRIPT OF PROCEEDINGS

Customs Courtroom, 421 U. S. Appraisers Building, 630 Sansome Street, San Francisco, California. Friday, October 10, 1958.

The above-entitled matter came on for hearing pursuant to Call of the Calendar, at 9:45 o'clock a.m.

Before: The Honorable Marion J. Harron.

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Opening Statement on Behalf of the Petitioners by Mr. S. H. Dobrzensky

Mr. S. H. Dobrzensky: As your Honor has already indicated, the case originally involved three issues: The depreciation on the dam, the legal fees, and the gain question, the deficiency proposed, which, as your Honor has already noted, and the years in question.

The sole remaining point of controversy is the question of the taxability of shares of stock received in a boot transaction, it being the contention of Respondent that the total consideration of shares, plus the cash boot, constituted taxable gain. The question of the deductibility of the aggregate of fees we have already disposed of, I think, by your Honor's questions.

The same is true with respect to the depreciation of the dam.

Since all of the facts on the question of the taxability of the exchange are stipulated, that issue is purely a legal one that can be argued in the briefs without the necessity of the introduction of any further evidence; that is, upon the filing of the stipulation.

* * * * *

[Endorsed]: T.C.U.S. Filed October 24, 1958.

32 T. C. No. 57

Tax Court of the United States

Grover D. Turnbow and Ruth H. Turnbow, Petitioners, v. Commissioner of Internal Revenue, Respondent.

Docket No. 69429. Filed June 12, 1959.

FINDINGS OF FACT AND OPINION

Petitioner, who owned all of the stock of Supply, exchanged all of such stock for shares of stock of Foremost Dairies, Inc., and $3,000,000. He reported gain limited to $3,000,000, less expenses, under section 112(c)(1), 1939 Code. Respondent determined that gain in excess of $3,000,000 was taxable because section 112(c)(1) was not applicable. Held, the provisions of section 112(c)(1) are applicable and petitioner's gain is recognized but only in an amount which does not exceed the cash payment.

M. W. Dobrzensky, Esq., and S. H. Dobrzensky, Esq., for the petitioners.

Nat. F. Richardson, Esq., for the respondent.

The Commissioner determined deficiencies in income tax for the taxable years 1952 and 1953 in the amounts of $264,037.43 and $14,786.26, respectively. The question is whether or not section 112 (c)(1), 1939 Code, applies to a transaction in which petitioner received cash and stock in an acquiring corporation in exchange for all of the stock in another corporation, which became a subsidiary of

the acquiring corporation, so that the taxable gain to be recognized is limited to the amount of cash received.

Findings of Fact

The petitioners, residents of San Francisco, California, filed joint income tax returns for the taxable years with the collector of internal revenue for the first district of California. Since the issue to be decided relates only to Grover D. Turnbow, he is referred to hereinafter as the petitioner.

Petitioner owned all of the outstanding stock of International Dairy Supply Co. (a Nevada corporation) and International Dairy Engineering Co. (a California corporation). International Dairy Supply Co. (a Nevada corporation) owned 60 per cent of the stock of Diamond Dairy, Inc., and a group of individuals represented by petitioner owned the remaining 40 per cent of the stock of Diamond Dairy, Inc.

Foremost Dairies, Inc., a New York corporation (hereinafter called Foremost), which has its principal place of business in Jacksonville, Florida, is engaged in the business of processing and distributing milk, cream, and other dairy products.

International Dairy Supply Co. (hereinafter called Supply[1]) had, and still has, its principal office in San Francisco. The main part of its business was furnishing reconstituted milk and

[1] The parties also refer to this corporation as International.

milk products to the Armed Forces of the United States, located outside the country, under contracts with the United States. Supply prepared dehydrated milk and milk products in this country and shipped such products to plants, which it operated in foreign countries, where the dehydrated milk and milk products were converted into liquid milk, chocolate drinks, ice cream, and similar products. Since it began business, 95 per cent of Supply's gross income has been derived from sources other than sources within the United States. In 1952, Supply was a party to a contract with the United States which had been executed in 1948 and which was a continuing contract in good standing. Supply also had a contract with the United States to furnish milk products to the Armed Forces in the Far East Command.

In 1952, there was only one class of stock of Supply issued, namely, voting capital stock. There were 5,000 shares outstanding, all of which were owned by Grover D. Turnbow.

In 1952, International Dairy Engineering Co. (hereinafter called Engineering) was engaged in constructing a plant at Atwater, California. Its total outstanding stock consisted of 100 shares, which were owned by Turnbow.

In 1952, the outstanding capital stock of Diamond Dairy, Inc. (hereinafter called Diamond) consisted of 25,000 snares, of which Supply owned 15,000 shares, 60 per cent, and individuals owned 10,000 shares, 40 per cent.

In 1951, Foremost and Turnbow began negotiations and entered into an agreement under which Foremost was to acquire all of the stock of the three corporations above named in what was intended to be a tax-free reorganization. Upon completion of preliminary matters in the early part of 1952, a supplemental agreement, called "Amendatory Agreement," was executed by Foremost and Turnbow on February 11, 1952. The amendatory agreement is incorporated herein by this reference. It included, inter alia, the reorganization plan.

Under the reorganization plan the following was to be done: (1) Foremost was to acquire from Turnbow all of the capital stock of Supply (5,000 shares), and Turnbow was to receive in exchange 82,375 shares of the common stock of Foremost, plus $3,000,000. Supply was thereby to become a wholly owned subsidiary of Foremost; it was to continue in the operation of its business. (2) Foremost was to acquire from Turnbow all of the outstanding capital stock of International Dairy Engineering Co. (100 shares), and Turnbow was to receive in exchange 60,000 shares of the common stock of Foremost. International Engineering was thereby to become a wholly owned subsidiary of Foremost, and it was to continue in the operation of its business. (3) Under the first exchange of stock, Foremost would gain control of 60 per cent of the capital stock of Diamond Dairy, Inc., which was owned by Supply. Having acquired control of Diamond, Foremost, pursuant to the plan of reorganization, was to acquire the minority stock of

Diamond, 10,000 shares, by giving 10,000 shares of Foremost common stock in exchange for 10,000 shares of capital stock of Diamond, which Turnbow agreed to deliver. Neither Supply, Engineering, Diamond, nor Foremost was to make any distribution to its respective shareholders in pursuance of the plan of reorganization, or otherwise.

It was contemplated, under the reorganization plan, that the number of directors of Supply and Engineering would be changed so that Turnbow would maintain three directors thereon and Foremost would elect three directors; that Supply would create an executive committee consisting of three members, two of which would be nominated by Foremost: that Turnbow would be the president and general manager of Supply and Engineering, and that Turnbow's nominee would be president and/or general manager of Diamond; that Turnbow's salary would be in the same amount as the salary of the president of Foremost; that the president of Foremost might become the vice-president of Supply and of Engineering, and the chairman of the executive committee of each company; that Turnbow would become a member of the board of directors and of the executive committee of Foremost, and would have the right to nominate two directors, in addition to himself, to Foremost's board of directors; that Turnbow would be elected chairman of Foremost's executive committee; and that Turnbow would execute a formal agreement with Foremost not to compete with either Supply, Engineering, or Foremost in the type of business

carried on by each, other than the business of farming, cattle raising, or the farm production of milk. Furthermore, it was contemplated by the parties that there would be two divisions of the business of Foremost, the Eastern division, and the Western and International division; and that Turnbow would be known as the general manager of the Western and International division, and Paul E. Reinhold (the president of Foremost) would be known as the general manager of the Eastern division.

The closing date under the 1952 agreement was March 3, 1952. Prior to the closing dated Turnbow was to do the following things: He was to purchase a ranch and certain personal property for cash from Engineering, and he was to convey all title to a patent application to Engineering. Also, he was to pay $500,000 to Engineering as a capital contribution, and it was agreed that the plant which Engineering was constructing at Atwater would cost in excess of $600,000, and would be completed, substantially, by April 15, 1952. Turnbow was, further, to purchase for cash from Supply certain notes receivable of three stockholders of Diamond for $61,142, and a note of a Dr. Kempf for $3,150.

The terms of the agreement of February 11, 1952, were carried out.

On March 3, 1952, the exchange of the stock of Supply for stock of Foremost was consummated, and Turnbow received 82,375 shares of the common stock of Foremost (a minority interest) in exchange for all of the capital stock of Supply. Turnbow

also received cash from Foremost in the amount of $3,000,000. Since his expenses in connection with the exchange were $15,007.23, the net amount of the cash he received was $2,984,992.77.

On March 3, 1952, the 83,375 shares of common stock of Foremost had a fair market value of $15 per share.

In the exchange of the stock of Supply, Foremost acquired all of the issued and outstanding shares of stock of Supply, of all classes. In the exchange, petitioner acquired only the 82,375 shares of common stock of Foremost and cash in the amount of $3,000,000 ("boot"), and Foremost acquired only all of the issued and outstanding shares of the voting capital stock of Supply.

In the income tax return of the petitioner for 1952, he reported long-term capital gain from the above-described transaction in the amount of $2,984,992.77, under the provisions of sections 112(b)(3) and 112(c)(1).

The Commissioner's determination was as follows:

In 1952 you exchanged 5,000 shares of International Dairy Supply Company capital stock for $3,000,000.00 in cash and 82,375 shares of capital stock of Foremost Dairies, Inc. You determined that the gain to be recognized was limited to the amount of cash received. In your return you reported a gain of $2,984,992.77 ($3,000,000.00 less $15,007.23 expense of exchange). It is held that the entire gain realized upon the exchange constituted

taxable income. The adjustment to the income reported in your return is computed as follows:

Amount received on exchange:		
Cash		$3,000,000.00
82,375 shares of Foremost Dairies, Inc. valued at $15.00 a share		1,235,625.00
Total received		$4,235,625.00
Less: Basis of stock exchanged	$50,000.00	
Expenses per return	20,981.80	
Add'l legal fees allowed	951.26	71,933.06
Gain recognized		$4,163,691.94
Gain reported		2,984,992.77
Additional gain recognized		$1,178,699.17
Adjustment to income—50 percent		$ 589,349.59

Opinion

Harron, Judge: Petitioner owned all of the outstanding stock of Supply, which was voting stock. In 1952, he received in exchange for all of his stock in Supply 82,375 shares of common stock of Foremost and $3,000,000 in cash, so-called "boot." The question before us is limited to whether the provisions of section 112(c)(1) of the 1939 Code[2]

[2] Sec. 112(c) Gain From Exchanges Not Solely in Kind.—

(1) If an exchange would be within the provisions of subsection (b)(1), (2), (3), or (5), or within the provisions of subsection (1), of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph or by subsection (1) to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and and the fair market value of such other property.

apply to the transaction. Respondent has determined that section 112(c)(1) does not apply and, that therefore, the entire gain is taxable under section 112(a).

Petitioner contends that, in considering whether section 112(c)(1) applies to the transaction, it is necessary and proper to look to section 112(b)(3)[3] after omitting the cash payment involved in the transaction. Respondent contends that there must be a qualifying reorganization within the meaning of section 112(g)(1)(B)[4] before section 112(c)(1) can come into play insofar as section 112(c)(1) refers to an exchange within the provisions of section 112(b)(3).

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[3] Sec. 112. Recognition of Gain or Loss.

(a) General Rule.—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) Exchanges Solely In Kind.—

* * * * *

(3) Stock for stock on reorganization.—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

[4] Sec. 112(g) Definition of Reorganization.—As used in this section * * *.—

(1) The term "reorganization" means * * *, or (B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation, * * *.

Subsection (b) of section 112 allows various exceptions from subsection (a), which states the general rule that the entire amount of the gain shall be recognized upon the sale or exchange of property. Subsection (b) deals with exchanges solely in kind, whereas subsection (c) deals with the treatment of gain from exchanges which are not solely in kind, but only if an exchange would be within (1), (2), (3), or (5), if it were not for the fact that the property received in exchange consists not only of property permitted by (1), or (2), or (3), or (5), but also of other property on money. Directing our attention to section 112(b)(3), it is noted that among the requirements contained therein is the specification that the property involved must be stock or securities which is exchanged solely for stock or securities. Both of the sections involved here, subsection (b)(3) and subsection (c)(1), are provisions of long standing which were reenacted in the successive revenue acts which preceded the 1939 Code. In both the regulations of the Commissioner and in this Court's interpretation of section 112(c)(1), it has been understood that in order to give effect to the provisions of section 112(c)(1) the method to be followed is first to omit the item of cash (or other property) from the transaction and then to determine whether the exchange would be within subsection (b)(3). Otherwise, section 112(c)(1) would have no meaning in the context of its references to particular subsections of section 112(b).

In Luther Bonham, 33 B.T.A. 1100, 1103-4 (1936),

this Court concluded that the method of applying the statute was as follows:

* * * It is necessary therefore to determine whether or not the exchange of * * * stock for * * * stock would be within the provisions of subsection (b)(3) if the item of cash had been omitted and only * * * stock had been received in exchange for * * * stock. (Underscoring supplied.)

In Howard v. Commissioner, 238 F. 2d 943, 948 (1956), reversing 24 T.C. 792, on the basis of a question which was not reached by this Court, the following was stated:

Thus we may conclude that, in determining when these so-called "boot" provisions apply, Congress intended that the transaction is to be considered separately and apart from the "boot" received in determining whether it meets the nonrecognition provisions. If the transaction, absent from the "other property or money," fulfills the requirements of section 112(b)(3), then gain is to be recognized to the extent that "boot" is received.

In the instant case, but for the cash received in exchange for * * * common stock of Binkley, the transaction would have met the "solely" requirement of section 112(g)(1)(B) and fallen within the scope of section 112(b)(3). To the extent that "boot" was received, gain would be recognized under our interpretation of section 112(c)(1). * * *

The view expressed in Howard v. Commissioner, supra, corresponds with the opinion which was expressed by this Court in the Bonham case. Our

problem here is whether we should adhere to our understanding of the method to be followed in determining whether section 112(c)(1) applies in an exchange of stock solely for stock, plus money.

Consideration has been given to the respondent's regulation, Regs. 118, sec. 39.112(g)-4 (issued September 26, 1953, and applicable to taxable years beginning after December 31, 1951), which is set forth in the margin.[3] Regs. 111, sec. 29.112(g)-4

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[3] Sec. 39.112(g)-4 Exchanges in reorganization for stock or securities and other property or money.

(a) If in an exchange of stock or securities in a corporation a party to a reorganization, in pursuance of the plan of reorganization, for stock or securities in the same corporation or in another corporation a party to the reorganization, there is received by the taxpayer other property (not permitted to be received without the recognition of gain) or money, then

(1) As provided in section 112(c)(1), the gain, if any, to the taxpayer will be recognized in an amount not in excess of the sum of money and the fair market value of the other property, but

(2) The loss, if any, to the taxpayer from such an exchange is not to be recognized to any extent (see section 112(c)).

(b) The application of paragraph (a) of this section may be illustrated by the following example:

Example. A, in connection with a reorganization, in 1952, exchanges a share of stock in the X Corporation purchased in 1929 at a cost of $100 for a share of stock of the Y Corporation (a party to the reorganization), which has a fair market value of $90, plus $20 in cash. The gain from the transaction is $10 and is recognized and taxed as a gain from the exchange of property. But see section 117. However, if the share of stock received had a fair market value of $70, the loss from the transaction of $10 would not be recognized.

(issued by respondent in October 1943 and applicable to taxable years beginning after December 31, 1941) contain provisions which are identical with Regs. 118, sec. 39.112(g)-4. The provisions of section 112(c)(1) of the 1939 Code were reenacted in substantially identical language in section 351 (b) of the 1954 Code, and respondent's regulations promulgated under the 1954 Code, section 1.351-2(a) restate in substantially identical language what was stated in Regs. 111, sec. 29.112(g)-4, and Regs. 118, Sec. 39.112(g)-4.

Thus, there has been a long-standing and continuous construction of section 112(c)(1) (and the corresponding section in the earlier revenue acts) which has remained unchanged over the years in the face of the several reenactments of the statutory provision, as well as the amendment in the 1934 Act of section 112(g)(1)(B), when there was introduced into subsection (g)(1)(B) the word, "solely," in harmony with the provisions of subsections (b)(2), (b)(3), (b)(4), and (b)(5) which also contained the word, "solely," and contained "solely" for many years. The respondent's regulations, therefore, are deemed to have received the approval of Congress. Helvering v. Winmill, 305 U.S. 79; Lykes v. United States, 343 U.S. 118. Respondent has not offered any explanation for his departure in this case from his long-standing interpretation of section 112(c)(1) set forth in his regulations.

In this circumstance, and since this Court's view of the method to be followed in applying the pro-

visions of section 112(c)(1) is in accord with the respondent's long-standing regulations, we do not find cause for changing our construction of section 112(c)(1), and in this case we conclude that it should be followed.

The respondent's error is that he has seen fit here not to omit the item of cash in determining whether the transaction of petitioner and Foremost involved an exchange of the stock of Supply solely for stock of Foremost within the provisions of section 112(b)(3).

Accordingly it is held, that but for the cash received by petitioner in the transaction involving the exchange of all of the stock of Supply for part of the stock of Foremost, the exchange would have met the "solely" requirement of section 112(g)(1)(B) and fallen within section 112(b)(3). Howard v. Commissioner, supra, p. 948. Therefore, under section 112(c)(1) the gain to petitioner may not be recognized in an amount in excess of $2,984,992.77, which is the net amount of $3,000,000 less allowable expenses.

Recomputations are required under Rule 50 because of concessions or abandonment of the parties in respect to other adjustments.

Decision will be entered under Rule 50.

[Seal]

Served June 12, 1959.

Tax Court of the United States
Washington

Docket No. 69429

GROVER D. TURNBOW and RUTH H. TURNBOW, Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

DECISION

Pursuant to the determinations of the Court, as set forth in its Findings of Fact and Opinion filed June 12, 1959, the respondent has filed recomputations under Rule 50, with which the petitioners agree. Accordingly, it is

Ordered and Decided: That there are deficiencies in income taxes for the taxable years 1952 and 1953 in the amounts of $5,694.30 and $13,404.73, respectively.

[Seal] /s/ MARION J. HARRON,
Judge.

Entered August 31, 1959. Served September 1, 1959.

In the United States Court of Appeals
for the Ninth Circuit

T. C. Docket No. 69429

COMMISSIONER OF INTERNAL REVENUE,
Petitioner on Review,

vs.

GROVER D. TURNBOW and RUTH H. TURNBOW,
Respondents on Review.

PETITION FOR REVIEW

To the Honorable Judges of the United States Court of Appeals for the Ninth Circuit:

The Commissioner of Internal Revenue petitions the United States Court of Appeals for the Ninth Circuit to review the decision of the Tax Court of the United States entered herein on August 31, 1959, pursuant to its opinion filed June 12, 1959 (32 T.C. No. 57), ordering and deciding: "That there are deficiencies in income taxes for the taxable years 1952 and 1953 in the amounts of $5,694.30 and $13,404.73, respectively."

This petition for review is filed and taken pursuant to the provisions of Sections 7482 and 7483 of the Internal Revenue Code of 1954 and applicable amendments thereof.

Jurisdiction

The respondents on review, Grover D. Turnbow and Ruth H. Turnbow, husband and wife, who resided in San Francisco, California, filed joint Fed-

eral income tax returns for the taxable years 1952 and 1953, the years involved herein, with the Collector (now District Director) of Internal Revenue for the First District of California, whose office is located at San Francisco, California, which collection district is within the jurisdiction of the United States Court of Appeals for the Ninth Circuit, wherein this review is sought.

Nature of Controversy

The primary question to be presented to this Court is whether or not Section 112(c)(1) of the Internal Revenue Code of 1939 applies to a transaction in which the respondents received cash and stock in an acquiring corporation in exchange for all the stock in another corporation, which became a subsidiary of the acquiring corporation, so that the taxable gain to be recognized is limited to the amount of cash received.

In a transaction, the details of which are fully stated in the Findings of Fact of the Tax Court herein, the respondent, Grover D. Turnbow, sole stockholder of International Dairy Supply Company (hereinafter referred to as "Supply") on March 31, 1952 transferred all his capital stock (5000 voting shares) to Foremost Dairies, Inc. (hereinafter referred to as "Foremost") for 82,375 shares of Foremost common stock with a fair market value of $15.00 per share, plus $3,000,000.

In the income tax return of the respondents for 1952, they reported long-term capital gain from the transaction in the amount of $2,984,992.77, under

the provisions of Section 112(b)(3) and Section 112(c)(1) of the 1939 Code, which amount is $3,000,000 less expenses incurred in connection with the exchange.

The Commissioner held that the entire gain realized in the transaction of $4,163,691.94 was taxable and, accordingly, increased long-term capital gains reported.

The respondents contended that, in considering whether Section 112(c)(1) applies to the transaction, it is necessary and proper to look to Section 112(b)(3) of the 1939 Code, after omitting the cash payment involved in the transaction. The Commissioner contended that there must be a qualifying reorganization within the meaning of Section 112(g)(1)(B) before Section 112(c)(1) can come into play in so far as Section 112(c)(1) refers to an exchange within the provisions of Section 112(b)(3).

The Tax Court believed that the Commissioner erred in not omitting the item of cash in determining whether the transaction of respondent and "Foremost" involved an exchange of stock of "Supply" solely for stock of "Foremost" within the meaning of the provisions of Section 112(b)(3). The Tax Court, accordingly, held that, but for the cash received by the respondent in the transaction involving the exchange of all of the stock of "Supply" for part of the stock of "Foremost", the exchange would have met the "solely" requirements of Section 112(g)(1)(B) and fallen within Section 112(b)(3); and therefore under Section 112(c)(1) the gain to the respondents may not be recognized

in an amount in excess of $2,984,992.77, which is the net amount of $3,000,000 less allowable expenses.

In reaching its conclusion, the Tax Court followed the Seventh Circuit's decision in Howard v. Commissioner (C.A. 7, 1956) 238 F.2d 943, and its interpretation of the regulations (Reg. 118, Sec. 39.112(g)(4) as set out in its prior opinion in Luther Bonham (1936) 33 B.T.A. 1100.

It is submitted that the Seventh Circuit ignored the explicit provisions of Sections 112(b)(3), 112 (c)(1) and 112(g) of the 1939 Code which require a statutory reorganization independent of Section 112(c)(1). While Section 112(c)(1) refers to Section 112(b)(3), it does not refer to Section 112(g). The Tax Court erroneously interpreted the Commissioner's regulations. Section 39.112(c)-1(c), which refers to the reorganization provisions of Section 39.112(g) assumes the existence of a reorganization before Section 112(c)(1) could apply, as does Section 39.112(g)-(4) which the Tax Court misinterpreted. Also, see Section 39.112(g)-1(c) wherein it is stated that Section 112(b)(3) and 112(c)(1) in so far as it refers to Section 112 (b)(3), does not apply in the absence of a reorganization.

It is also submitted that the method chosen by the Tax Court to apply Section 112(c)(1) to Section 112 (b)(3)in the absence of a transaction which independently qualifies as a Section 112(g) reorganization has no statutory or judicial basis. Furthermore, such method destroys the rigid qualifying requirements for the reorganizations defined in Sec-

tions 112(g)(1)(B) and 112(g)(1)(C), both of which contain the "solely" requirement. The word "solely" contains no leeway. (Helvering v. Southwest Consolidated Corp. (1942) 315 U. S. 194.

It is, accordingly, submitted that the Tax Court erroneously held and concluded that Section 112 (c)(1) is applicable to the transaction herein and that the resulting gain is taxable only in an amount which does not exceed the cash payment (less allowable expenses).

Assignment of Errors

The following assignment of errors is presented as a basis of the review herein:

That the Tax Court of the United States erred:

1. In holding and concluding that the provisions of Section 112(c)(1) of the Internal Revenue Code of 1939 are applicable to the transaction hereinabove set forth.

2. In failing to hold and conclude that the provisions of Section 112(c)(1) of the Internal Revenue Code of 1939 are not applicable to the transaction hereinabove set forth.

3. In holding and deciding that the taxpayers' gain on the transaction is recognized but only in an amount which does not exceed the cash payment.

4. In failing to hold and decide that the entire gain is taxable under Section 112(a) of the Internal Revenue Code of 1939.

5. In failing to hold and decide that there must be a qualifying reorganization within the meaning of Section 112(g)(1)(B) of the 1939 Code before

Section 112(c)(1) can come into play in so far as such section refers to an exchange within the meaning of Section 112(b)(3).

6. In holding and deciding that in construing Section 112(c)(1) and determining the method to be followed in deciding whether it applies to a transaction where stock is exchanged solely for stock, plus money, it is necessary and proper to look to Section 112(b)(3) of the 1939 Code, after omitting the cash payment involved in the transaction.

7. In holding and concluding that its view of the method to be following in applying the provisions of Section 112(c)(1) is in accordance with the Commissioner's long-standing regulations.

8. In holding and deciding that the Commissioner erred in that he did not omit the item of cash in determining whether the transaction of the taxpayer and "Foremost" involved an exchange of stock of "Supply" solely for stock of "Foremost" within the provisions of Section 112(b)(3) of the 1939 Code.

9. In failing to order and decide that there are deficiencies in income tax for the years 1952 and 1953 in the amounts determined by the Commissioner in the notice of deficiency as adjusted by concessions and abandonment by the parties with respect to certain other items.

10. In denying the Commissioner's Request for Review by the Tax Court of a Division Report.

11. In denying the Commissioner's Motion for Reconsideration.

12. In ordering and deciding that there are deficiencies in income tax for the years 1952 and 1953 in the amounts of $5,694.30 and $13,404.73, respectively.

13. In that its decision and opinion are contrary to the law and the regulations and are not supported by substantial evidence of record.

Wherefore, it is accordingly prayed that this Honorable Court review the matters and errors complained of herein, and reverse the decision of the Tax Court of the United States entered herein, and remand the case to the Tax Court for further proceedings.

/s/ CHARLES K. RICE,
Assistant Attorney General,
/s/ HART H. SPIEGEL,
Chief Counsel, Internal Revenue Service,
Counsel for Commissioner of Internal Revenue.

Of Counsel: C. R. Marshall, Special Attorney, Internal Revenue Service.

[Endorsed]: T.C.U.S. Filed November 18, 1959.

[Title of Tax Court and Cause.]

CERTIFICATE

I, Howard P. Locke, Clerk of the Tax Court of the United States, do hereby certify that the documents submitted under this certificate, 1 to 24, in-

clusive, as called for by the Designation for Contents of Record on Review, are the original documents on file in my office, and a true copy of the docket entries as they appear in the official docket of my office, in the case docketed at the above number, in which the respondent in this Court has filed a petition for review.

In testimony whereof, I hereunto set my hand and affix the seal of the Tax Court of the United States, at Washington, in the District of Columbia, this 1st day of February, 1960.

[Seal] /s/ HOWARD P. LOCKE,
Clerk of the Court.

[Endorsed]: No. 16775. United States Court of Appeals for the Ninth Circuit. Commissioner of Internal Revenue, Petitioner, vs. Grover D. Turnbow and Ruth H. Turnbow, Respondents. Transcript of the Record. Petition to Review a Decision of The Tax Court of the United States.

Filed and Docketed: February 13, 1960.

/s/ FRANK H. SCHMID,
Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 16775

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

GROVER D. TURNBOW and RUTH L. TURNBOW,
Respondents.

STATEMENT OF POINTS TO BE RELIED UPON

The Commissioner of Internal Revenue, petitioner herein, by his counsel, submits the following statement of points upon which he intends to rely as the basis of his petition for review:

That the Tax Court of the United States erred:

1. In failing to hold and conclude that the provisions of Section 112(b)(3) and (c)(1) of the Internal Revenue Code of 1939 are not applicable to the gain realized by the taxpayers in a transaction whereby they exchanged stock in one corporation for stock in another corporation plus cash.

2. In holding and deciding that the taxpayers' gain on the transaction in question is recognized but only in an amount which does not exceed the cash payment received.

3. In failing to hold and decide that the entire

gain in question is taxable under Section 112(a) of the Internal Revenue Code of 1939.

4. In failing to hold and decide that there must be a qualifying reorganization within the meaning of subsection (g)(1)(B) of Section 112 of the Internal Revenue Code of 1939 before subsection (c)(1) thereof can come into play in so far as it refers to an exchange within the meaning of subsection (b)(3).

5. In failing to order and decide that there are deficiencies in income tax for the years 1952 and 1953 in the amounts determined by the Commissioner in the notice of deficiency as adjusted by concessions and abandonment by the parties with respect to certain other items.

6. In ordering and deciding that there are deficiencies in income tax for the years 1952 and 1953 in the amounts of $5,694.30 and $13,404.73, respectively.

7. In that its decision and opinion are contrary to law and the applicable Treasury Regulations.

Dated: March 16, 1960.

/s/ CHARLES K. RICE,
Assistant Attorney General,
Attorney for Petitioner.

[Endorsed]: Filed March 21, 1960. Frank H. Schmid, Clerk.

[fol. 54]

IN UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

MINUTE ENTRY OF ARGUMENT AND SUBMISSION—October 4, 1960 (omitted in printing).

[fol. 55]

MINUTE ENTRY OF ORDER DIRECTING FILING OF OPINION AND FILING AND RECORDING OF JUDGMENT—December 5, 1960 (omitted in printing).

[fol. 56]

IN UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

No. 16,775

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

vs.

GROVER D. TURNBOW and RUTH H. TURNBOW, Respondents.

Upon Petition to Review a Decision of The Tax Court of the United States

OPINION—December 5, 1960

Before: Merrill and Koelsch, Circuit Judges, and Bowen, District Judge

Merrill, Circuit Judge:

This case presents the following question: whether gain realized by a taxpayer upon the transfer of his stock in a wholly owned corporation in consideration for voting stock in another corporation plus cash is recognizable in its entirety or only to the extent of the cash received. The Tax Court, following Howard vs. Commissioner of Internal Revenue, 7 Cir., 1956, 238 F. 2d 943, has ruled that the gain is

recognizable only to the extent of the cash received. Grover D. Turnbow, 32 T. C. 646. We have concluded that this was error and that the gain is recognizable in its entirety.

The taxpayer, Turnbow, was the sole stockholder of International Dairy Supply Company, a Nevada corporation which had its principal place of business in San Francisco, California. In 1952, the taxpayer transferred his stock in that company to Foremost Dairies, Inc., a New York corporation which had its principal place of business in Jacksonville, Florida. This transfer was in exchange for 82,375 shares of the common stock of Foremost and [fol. 57] $3,000,000.00 cash, so-called "boot." The Foremost shares were of a value of $1,235,625.00. Thus the shares constituted 29% of the total consideration received, while the boot constituted 71%.

The taxpayer reported a capital gain on the transaction limited to the $3,000,000.00 cash boot, less expenses which by agreement he had undertaken to assume. The Commissioner determined that the entire gain on the transaction was taxable, establishing that gain at $4,163,691.94. Tax deficiencies for the years 1952 and 1953 in the amounts, respectively, of $264,037.43 and $14,786.26 were determined.

The taxpayer petitioned the Tax Court for review. That court held that gain on the transaction should be limited to the cash boot. The deficiencies were disallowed. The Commissioner has petitioned this court for review.

The problem presented involves construction of § 112 of the Internal Revenue Code of 1939, which deals with recognition of gain or loss.

Section 112(a) sets forth the general rule that "upon the sale or exchange of property the entire amount of gain or loss * * * shall be recognized, except as hereinafter provided in this section."

Among the exceptions specified, § 112(b) deals with exchanges solely in kind, and § 112(b)(3) deals with exchanges of stock for stock on reorganization. It provides:

> "No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization."

The term "reorganization," as used in § 112(b)(3), is defined in § 112(g)(1), which, as amended in 1943, provides:

> "The term 'reorganization' means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation, or (C) the acquisition by one corporation, in exchange solely for all or a par. of its voting stock, of [fol. 58] substantially all the properties of another corporation, but in determining whether the exchange is solely for voting stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded, or (D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its shareholders or both are in control of the corporation to which the assets are transferred, or (E) a recapitalization, or (F) a mere change in identity, form, or place of organization, however, effected."

In this case we are concerned with the definition set forth in Clause (B) of § 112(g)(1). Our discussion also deals with the definition set forth in Clause (C). Today these types of reorganization are known to the tax bar as (B) and (C) reorganizations and we shall take advantage of this terminology.

Section 112(c) is the section upon which the taxpayer relies for his right to limit recognition of gain to the cash boot. As amended in 1943, § 112(c)(1) provides:

> "If an exchange would be within the provisions of subsection (b)(1), (2), (3), or (5), or within the provisions of subsection (1), of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph or by subsection (1) to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but

in an amount not in excess of the sum of such money and the fair market value of such other property."

The dispute before us is as to the method to be followed in applying § 112(c) to the facts of a case. The Tax Court purported to follow its earlier decision upon this problem in Luther Bonham, 1936, 33 B. T. A. 1100, 1103-1104. It quoted that opinion (supplying its own emphasis) as follows:

"It is necessary therefore to determine whether or not the exchange of * * * stock for * * * stock *would be* within the provisions of subsection (b)(3) *if the item of* [fol. 59] *cash had been omitted* and only * * * stock had been received in exchange for * * * stock."

Howard vs. Commissioner of Internal Revenue, supra at page 948, was also quoted to the following effect:

"In the instant case, *but for* the cash received in exchange for * * * common stock of Binkley, the transaction would have met the 'solely' requirement of section 112(g)(1)(B) and fallen within the scope of section 112(b)(3). To the extent that 'boot' was received, gain would be recognized under our interpretation of section 112(c)(1)."

Applying this method to the case at bar, the taxpayer reasons: but for the cash received, the transaction—solely stock for stock—would have met the "solely" requirements of both §§ 112(b)(3) and 112(g)(1)(B) and fallen within the nonrecognition provision of § 112(b)(3). Therefore, he says, under § 112(c) the gain to be recognized is limited to the amount of the cash received.

The Commissioner contends that § 112(b)(3) requires an actual and not a hypothetical reorganization before nonrecognition can result; that petitioner's method assumes the absence of boot not only to determine whether § 112(b)(3) would apply but also to determine whether the § 112(g)(1)(B) definition would apply; that this does violence to § 112(b)(3), which expressly contemplates the existence of a reorganization.

The method of applying § 112(c), advocated by the Commissioner, is to ascertain first whether a reorganization

exists under § 112(g)(1). If it does, then and only then can the nonrecognition provisions of § 112(b)(3) become applicable. If it does not, § 112(b)(3) cannot apply. Only when § 112(b)(3) applies, can § 112(c) operate to modify its consequences.

Applying this method to the case at bar, the Commissioner reasons that, since the presence of boot precludes a (B) reorganization, § 112(b)(3) cannot apply and the gain is subject to taxation under § 112(a). Under the Commissioner's construction, (B) and (C) reorganizations are forever excluded from the operation of § 112(c). The other types of reorganizations specified in § 112(g)(1), however, do remain subject to the operation of § 112(c).

[fol. 60] Upon this dispute, legislative history supports the Commissioner's position.

Prior to 1934, there were no (B) or (C) reorganizations as such.[1] Section 112(i) of the Revenue Act of 1932 (the prior analogous section to § 112(g)(1) of the 1934 Act) read in pertinent part:

> "The term 'reorganization' means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation)."

The provisions of §§ 112(b)(3) and 112(c), however, existed in substantially their present form.

The reasons for the 1934 amendment of § 112(g)(1) are clearly disclosed by congressional reports and discussion. The House Ways and Means Committee Report, H. Rep. No. 704, 73d Congress, 2d Session 13 (1934) states:

> "The reorganization provisions have been in effect for many years, having been adopted in substantially their present form in 1924. They state in detail how each step of a reorganization should be treated for tax pur-

[1] Even the 1934 amendment did not separate (B) and (C) reorganizations. Both were dealt with under Clause (B). It was not until the Internal Revenue Code of 1939 that the separation occurred which has given rise to today's terminology.

poses. The policy was adopted of permitting reorganizations to take a wide variety of forms, without income-tax liability. As a result, astute lawyers frequently attempted, especially during the prosperous years, to take advantage of these provisions by arranging in the technical form of a reorganization, within the statutory definition, what were really sales."

A letter from the Secretary of the Treasury, which appears in the Congressional Record, 78 Cong. Rec. 2512 (1934) states:

"Exchanges and reorganizations. The Treasury regards it as desirable that business readjustments be permitted without tax consequences in cases where the stockholders in the enterprise are retaining their [fol. 61] interests without the receipt of cash and the essential continuity of the business is being preserved. On the other hand, the Treasury has suffered a considerable loss of revenue in recent years through the adroitness of attorneys in planning sales in such a way as to come within the scope of the reorganization provisions. The bill revises the definition of reorganization in order to eliminate serious loopholes in this provision, while legitimate exchanges and reorganizations may still be carried out without the realization of gain or loss. In the opinion of the Department, a considerable saving in revenue will result from these amendments without the injurious effects to business which would have been caused by a complete elimination of these provisions."

A subcommittee of the House Ways and Means Committee, studying the revision of the revenue act, was sufficiently exercised over avoidance practices to give serious consideration to the advisability of eliminating completely the provisions governing reorganization exchanges. H. Rep., December 4, 1933, 73d Congress, 2d Session, 8-9 (1933). However, the House Ways and Means Committee, in its report, stated:

"The committee decided that, under present conditions, the wiser policy is to amend the provisions drastically

to stop the known cases of tax avoidance, rather than to eliminate the sections completely." H. Rep. No. 704, 73d Congress, 2d Session, 13 (1934).

The House committee's solution was to eliminate from the definition of reorganization, as it then appeared in Clause (A), the parenthetical phrase following the words "merger or consolidation."

Had this solution been adopted, there would have been no (B) or (C) reorganizations and § 112(c) obviously could have no reference to such transactions.

The Senate Finance Committee reported, S. Rep. No. 558, 73d Congress, 2d Session, 16 (1934):

"Your committee is in complete agreement with the purposes of the House bill which aim at tax avoidance [fol. 62] schemes in this connection. However, some modifications are recommended in order to bring about a more uniform application of the provisions in all 48 of the States. Not all of the States have adopted statutes providing for mergers or consolidations; and, moreover, a corporation of one State cannot ordinarily merge with a corporation of another State. The committee believes that it is desirable to permit reorganizations in such cases, with restrictions designed to prevent tax avoidance. Consequently, the committee recommends the insertion in the House bill of an addition to the definition of the term 'reorganization' as follows: * * *"

Then follows the Clause (B) definition which was eventually incorporated into § 112(g)(1) of the 1934 act.

Emphasizing its views that the tax avoidance problems would be met, the report states at page 17:

"It will be noted that the proposed amendment requires that * * * the acquisition, whether of stock or of substantially all the properties, must be in exchange solely for the voting stock of the acquiring corporation."

It is clear from this history that, with specific abuses in mind, Congress sought to eliminate them by requiring that,

for an acquisition to qualify for the tax advantages of a reorganization, it must be in exchange solely for voting stock.

With reference to this requirement the Supreme Court has stated in Helvering vs. Southwest Consolidated Corporation, 1941, 315 U.S. 194, 198:

> "But clause B of § 112(g)(1) of the 1934 Act effects an important change as respects transactions whereby one corporation acquires substantially all of the assets of another. See S. Rep. No. 558, 73d Cong., 2d Sess., Committee Reports, Revenue Acts 1913-1938, pp. 598-599. The continuity of interest test is made much stricter. See Paul, Studies in Federal Taxation (3d Series), pp. 36-41. Congress has provided that the assets of the transferor corporation must be acquired in exchange 'solely' for 'voting stock' of the transferee. 'Solely' leaves no leeway. Voting stock plus some other consideration does not meet the statutory requirement. [fol. 63] See Hendricks, Developments in the Taxation of Reorganizations, 34 Col. L. Rev. 1198, 1202-1203."

Certainly it could not have been intended by Congress that this result would be frustrated at birth by the already existing provisions of § 112(c); yet such would seem to be the effect of the taxpayer's construction.

The Commissioner's construction seems supported by subsequent congressional action. If (B) reorganizations can hypothetically exist notwithstanding boot, the same would apply to today's (C)-type reorganizations, which also were created by the 1934 amendments.

> "• • • the acquisition by one corporation, in exchange solely for all or a part of its voting stock; • • • of substantially all the properties of another corporation • • •." § 112(g)(1)(B) of the Revenue Act of 1934.

Yet, in 1939, Congress saw fit to amend the definition of (C) reorganizations by providing:

> "• • • but in determining whether the exchange is solely for voting stock the assumption by the acquiring cor-

> poration of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded * * * ." § 112(g)(1)(C) of the Internal Revenue Code of 1939.

In § 368(a)(2)(B) of the Internal Revenue Code of 1954, the definition was further amended to provide that only 80% of the assets of the acquired corporation need be obtained in exchange for voting stock; that boot could, without defeating reorganization, be the consideration for assets above 80%. Under the taxpayer's construction, neither of these amendments was necessary. That Congress felt it necessary so to amend the section indicates that the Commissioner's construction reflects the true congressional intent and understanding.

The taxpayer refers us to a point emphasized in Howard vs. Commissioner of Internal Revenue, supra. Section 112 (e) is the counterpart of § 112(c), the latter dealing with recognition of gains and the former with recognition of [fol. 64] losses. Section 112(e) has remained virtually unchanged since its original enactment as § 203(f) of the Revenue Act of 1924. It provides:

> "If an exchange would be within the provisions of subsection (b)(1) to (5), inclusive, or (10), or within the provisions of subsection (1), of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized."

Howard points out that if the presence of boot results in recognition of gains it likewise results in recognition of losses; that a taxpayer desiring that a loss be recognized might convert what otherwise would be a legitimate reorganization into a sale by the payment of a trifling amount of cash; that such a construction would thus defeat the 1924 legislative intent in enacting § 112(e).

It would appear, however, that Congress in 1934 was aware that attempts might be made under the proposed

amendment to secure recognition of losses notwithstanding actual continuity of interest. The House Ways and Means Committee, as we have noted, recommended that the "acquisition" type of transaction (the forerunner of today's (B) and (C) reorganizations) be completely eliminated from the definition or reorganization. At the same time the report stated:

> "Furthermore, the retention of the other reorganization provisions will prevent large losses from being established by bondholders and stockholders who receive securities in a newly reorganized enterprise which are substantially the same as their original investments." H. Rep. No. 704, 73d Congress, 2d Session, 14 (1934).

Thus it would appear that in the judgment of Congress the danger of tax avoidance (through securing recognition of losses notwithstanding continuity of interest) was avoided by the probability that the acquisitions resulting in loss could be treated as reorganizations under the remaining provisions of § 112(g)(1).[2]

[fol. 65] Whether this judgment was sound apparently still remains to be tested. However, Congress would seem

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[2] The judgment of Congress would also seem to have taken into consideration the apparent lack of effectiveness of § 112(e) in preventing loss taking in corporation exchange transactions. The report of the subcommittee of the House Ways and Means Committee stated in H. Rep., December 4, 1933, 73d Congress, 2d Session 37-42 (1933):

> "The statute provides that upon sale or exchange of property, the entire amount of gain or loss shall be recognized with certain exceptions. The exceptions are the exchange and reorganization provisions already referred to. If a taxpayer desires to take a loss, it is easy to arrange a transaction falling without the exceptions. On the other hand, if it is desired to pay no tax on the gain, the transaction can be so arranged as to come within the exception. In addition, losses from the sale or exchange of stocks and bonds are limited, to a large extent, to gains from such sales or exchanges so in many cases a stock or bond loss, even if recognized, could not be utilized by the taxpayer."

This quote also appears at: Hearings before the House Committee on Ways and Means on the 1934 Revenue Bill, 73d Congress, 2d Session 60 (1934).

to have weighed the desirable features of the proposed amendment (as to gains) against its undesirable potentialities (as to losses). For us to permit the possibility of tax avoidance under § 112(e), to control our construction of § 112(c), would be to overrule the apparent judgment of Congress upon this very question.

The Tax Court opinion in this case points out that the Commissioner's regulations are deemed to have received the approval of Congress (citing Lykes vs. United States, 1951, 343 U.S. 118; Helvering vs. Winmill, 1938, 305 U.S. 79) and places reliance upon the Commissioner's regulations, 118, § 39.112(g)-4. In our view, this section casts little light on the problem. On the other hand, § 39.112(g)-1(c) of the regulations lends support to the Commissioner's position. It provides in part:

> "From its context the term 'a party to a reorganization' can only mean a party to a transaction specifically defined as a reorganization by section 112(g). • • • The provisions of the Internal Revenue Code referred to in this paragraph [this includes § 112(c)] are inapplicable unless there is a plan of reorganization. A plan of reorganization must contemplate the bona fide execution of one of the transactions specifically described as a reorganization in section 112(g) and for [fol. 66] the bona fide consummation of each of the requisite acts under which nonrecognition of gain is claimed."

We conclude that, if the "solely for voting stock" requirement of (B) and (C) reorganizations is to be given the effect intended by Congress, § 112(c) cannot operate to render a stock-plus-boot acquisition a (B) or (C) reorganization through a disregard of the existence of boot. In the case before us, then, the existence of boot prevents § 112(g)(1)(B) from applying; since no reorganization exists, § 112(b)(3) cannot apply; § 112(c) is then also inapplicable.

Reversed and remanded with instructions that the deficiencies determined by the Commissioner be reexamined in the light of this opinion.

[File endorsement omitted]

[fol. 67]

[File endorsement omitted]

IN UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

No. 16,775

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

vs.

GROVER D. TURNBOW and RUTH H. TURNBOW, Respondents.

JUDGMENT—Filed and Entered December 5, 1960

Upon petition to review a decision of the Tax Court of the United States.

This cause came on to be heard on the Transcript of the Record from the Tax Court of the United States, and was duly submitted.

On consideration whereof, it is now here ordered and adjudged by this Court that the decision of the said Tax Court of the United States in this cause be, and hereby is reversed, and that this cause be, and hereby is remanded to the said Tax Court of the United States with instructions that the deficiencies determined by the Commissioner be reexamined in the light of the opinion of this Court.

[fol. 68] Clerk's Certificate to foregoing transcript (omitted in printing).

[fol. 69]

SUPREME COURT OF THE UNITED STATES

No. 777—October Term, 1960

GROVER D. TURNBOW, ET AL., Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE

ORDER ALLOWING CERTIORARI—May 15, 1961

The petition herein for a writ of certiorari to the United States Court of Appeals for the Ninth Circuit is granted, and the case is transferred to the summary calendar.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

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JAMES R. BROWNING, Clerk

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1960

No. 60

GROVER D. TURNBOW and RUTH H. TURNBOW,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI to the United States Court of Appeals for the Ninth Circuit

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OPINIONS BELOW

The Findings of Fact and Opinion of the Tax Court (R. 29-42), printed in Appendix B, infra, pages iv-xvi, are reported at 32 T.C. 646. The opinion of the Court of Appeals (R. 56-66), printed in Appendix B, infra, pages xviii-xxx, has not yet been reported.

JURISDICTION

The judgment of the Court of Appeals was entered on December 5, 1960 (R. 66). The jurisdiction of this Court is invoked under section 1254 of Title 28 of the United States Code.

QUESTION PRESENTED

Whether, under § 112(c)(1) of the Internal Revenue Code of 1939, the gain to a taxpayer who has exchanged all of the voting stock of one corporation for a part of the voting stock of another corporation plus cash is recognized in the year of the transaction only to the extent of the cash, postponing recognition of the gain (if any) on the stock received until it becomes the subject of some later taxable transaction.

STATUTES INVOLVED

The case directly concerns the interpretation of § 112(c)(1) of the Internal Revenue Code of 1939 (53 Stat. 39), which provides in pertinent part:

> "If an exchange would be within the provisions of subsection (b) * * (3) * * of this section if it were

not for the fact that the property received in exchange consists not only of property permitted by such paragraph * * to be received without the recognition of gain, but also of * * money, then the gain * * to the recipient shall be recognized, but in an amount not in excess of * * such money * *."[1]

This statute and the pertinent portions of other statutes involved are set out in Appendix A, infra, pages i-iii.

STATEMENT OF THE CASE

The facts are not in dispute. As the Tax Court found (R. 36):

The taxpayer[2] owned all 5000 shares of the outstanding stock, all of which was voting stock, of International Dairy Supply Company, a Nevada corporation (hereinafter called "Supply")[3] (R. 30, 31). Supply's business, in the main, was furnishing reconstituted milk and milk products to the Armed Forces of the United States, located outside the country, under contracts with the United States (R. 30-31).

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[1]These provisions are retained in substantially the same form in the Internal Revenue Code of 1954, § 356.

[2]References to the taxpayer in this petition are to Grover D. Turnbow, inasmuch as his wife, Ruth H. Turnbow, is a party only because she filed a joint return with her husband for the taxable year involved.

[3]The taxpayer owned interests in two other corporations, which also entered into the transactions herein described. However, since there is now no issue in any way involving these other interests, reference to them is hereinafter omitted.

Foremost Dairies, Inc. (hereinafter called "Foremost"), was a New York corporation engaged in the business of processing and distributing milk, cream, and other dairy products (R. 30).

In 1951, Foremost and the taxpayer entered into an agreement under which Foremost was to acquire all of the stock of Supply in what was intended to be a tax-free reorganization (R. 32). Upon completion of preliminary negotiations, a supplemental agreement, called "Amendatory Agreement," was executed by Foremost and the taxpayer on February 11, 1952. The Amendatory Agreement included, inter alia, the reorganization plan (R. 32).

Under the reorganization plan Foremost was to acquire from the taxpayer all of the capital stock of Supply, and the taxpayer was to receive in exchange 82,375 shares of the common stock of Foremost (a minority interest), plus $3,000,000. Supply was thereby to become a wholly owned subsidiary of Foremost; it was to continue in the operation of its business. It was not to make any distribution to its shareholders in pursuance of the plan of reorganization or otherwise (R. 32-33).

The reorganization plan also provided for many changes in the management of both Foremost and Supply, with Turnbow to be president and general manager of Supply and also a director and chairman of the executive committee of Foremost and general manager of its Western and International Division, and with the right to name three of Supply's six directors and two of Foremost's directors (R. 33-34).

The terms of the Amendatory Agreement were carried out (R. 34).

On March 3, 1952, the exchange of the stock of Supply for stock of Foremost was consummated, and the taxpayer received 82,375 shares (then having a fair market value of $15 per share) of the common stock of Foremost and $3,000,000 cash, in exchange for all of the capital stock of Supply. Since his expenses in connection with the exchange were $15,007.23, the net amount of the cash he received was $2,984,992.77 (R. 34-35).

In his 1952 income tax return the taxpayer reported long-term capital gain from the above-described transaction in the amount of $2,984,992.77 (R. 35).

The Commissioner determined that the recognized gain from the transaction should be increased by $1,178,699.17 (the value of the Foremost stock at the date of the exchange less the cost basis of the stock of Supply, with certain adjustments not material here) (R. 35-36).

On the taxpayer's petition for redetermination, under § 272 of the Internal Revenue Code of 1939 (53 Stat. 82), the Tax Court held that the recognized gain on the transaction was limited to the cash "boot" (R. 29-42).

On petition for review under § 7482 of the Internal Revenue Code of 1954, the court below reversed the Tax Court (R. 56-66). Recognizing that the Tax Court had expressly followed the prior decision of the Court of Appeals for the Seventh Circuit in *Howard* v. *Commissioner of Internal Revenue* (7 Cir. 1956) 238 F.2d 943, and its own prior decision in *Luther Bonham* (1936) 33 B.T.A. 1100, on the identical problem (R. 56, 58), the court below refused to follow those decisions. It held that since the transaction *with the cash included* was not a

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In the Supreme Court
OF THE
United States

OCTOBER TERM, 1960

No. _____

GROVER D. TURNBOW and RUTH H. TURNBOW,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI
to the United States Court of Appeals
for the Ninth Circuit

Grover D. Turnbow and Ruth H. Turnbow pray that a writ of certiorari issue to review the judgment entered in this case on December 5, 1960, by the United States Court of Appeals for the Ninth Circuit, which reversed the judgment of the Tax Court of the United States entered August 31, 1959.

reorganization under § 112(g)(1)(B), gains on the exchange of the stock as well as to the extent of the cash received should be recognized. In so ruling it completely disregarded the specific direction in § 112(c)(1), providing that if the exchange would be within the provisions of § 112(b)(3)—i.e., would qualify as a reorganization—*if* it were not for the fact that the property received in the exchange consisted not only of stock but also of money,

> "then the gain * * to the recipient shall be recognized, but in an amount not in excess * * of such money * * *."

In so ruling the court also adopted an interpretation, directly contrary to that in the *Howard* case, of the provisions of § 112(e) of the 1939 Code (53 Stat. 39; Appx. A, infra, p. i), the correlative section dealing with *losses* from exchanges not solely in kind. *Howard* pointed out that the Commissioner's position would permit a taxpayer to escape the application of this provision by adding a nominal amount of cash to a stock-for-stock exchange and thus convert a paper loss into a tax loss. In the instant case, the court below considered that "Congress would seem to have weighed" these "undesirable potentialities" against the interpretation adopted by the court and to have accepted the consequences (R. 65).

REASONS FOR GRANTING THE WRIT

1. The decision below is directly in conflict with the decision of the Court of Appeals for the Seventh Circuit in Howard v. Commissioner of Internal Revenue (7 Cir. 1956) 238 F.2d 943.

The *Howard* case involved an exchange of stock for stock and cash. Some of the old shareholders received solely new stock for their old stock, others received solely cash for their old stock, and a few received both stock and cash for their old shares. After determining that the payment of the cash to some prevented the entire exchange from constituting a tax-free reorganization within the provisions of § 112(b)(3), the court then proceeded to determine whether the boot provisions of § 112(c)(1) applied to the exchange so as to postpone recognition of gain on the stock received. The court met and rejected the identical arguments which the Commissioner makes and the court below adopted in the instant case, and held that the presence of the cash payment, since *without* it the requirements of § 112(b)(3) would be met, did not defeat the application of § 112(c)(1) and no gain would be recognized except to the extent of the cash payment. The court said (pp. 947-948):

> "Petitioners [the taxpayers] contend that, in considering whether § 112(c) (1) applies to this transaction, it is necessary to look to § 112(b) (3) after omitting from consideration the cash payment involved in the transaction. On the other hand, respondent [the Commissioner] urges that there must be a qualifying reorganization within the meaning of § 112 (g) (1) (B) or (C) before § 112(c) (1) can come into play. He takes the position that 'section 112(c) makes it possible for other property or "boot" to be

received in the course of a reorganization without destroying qualification under the statute. This leeway does not, however, extend to the second and third types of reorganization namely reorganizations under section 112(g) (1) (B) and 112(g) (1) (C).'

We see no logical basis for this distinction. * * *

Thus we may conclude that, in determining when these so-called 'boot' provisions apply, Congress intended that the transaction is to be considered separate and apart from the 'boot' received in determining whether it meets the nonrecognition provisions. If the transaction, absent the 'other property or money', fulfills the requirements of § 112(b) (3), then gain is to be recognized to the extent that 'boot' is received.

In the present case, *but for* the cash received in exchange for 19.81% of the common stock of Binkley, the transaction would have met the 'solely' requirement of § 112(g) (1) (B) and fallen within the scope of § 112(b) (3). To the extent that 'boot' was received, gain would be recognized under our interpretation of the application of § 112(c) (1)" (italics by the court).

The decision below is also directly in conflict with the *Howard* decision on the important question of the tax treatment of *losses* from exchanges of property not solely in kind, under § 112(e) of the Internal Revenue Code of 1939. That statute, paralleling the language of § 112(c) (1), provides:

"If an exchange would be within the provisions of subsection (b)(1) to (5), inclusive, * * of this section if it were not for the fact that the property received in exchange consists not only of property permitted

> by such paragraph to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized."

The parallel language of the two sections demands a like reading (*Davies Warehouse Co. v. Bowles* (1944) 321 U.S. 144, 150)—a proposition recognized both in *Howard* (238 F.2d 948) and by the court below (R. 64). In *Howard*, the Court of Appeals for the Seventh Circuit reviewed the legislative history of § 112(e), particularly the report of the House Ways and Means Committee (H.Rept. 179, 68th Cong., 1st Sess., p. 15; C.B. 1939-1, Pt. 2, pp. 241, 252) explaining the precursor of that statute (238 F.2d 948):

> "*Unless some provision is made for cases in which part of the consideration is money, the provisions of subdivision (b) could be avoided and the entire amount of the loss recognized if a small amount of money were received in addition to the specified property.* The only way to cover such a case and prevent the taxpayer from taking the entire loss by adding a small amount of money to the property received is to provide that no loss shall be recognized, otherwise the law might be evaded" (italics by the court).

From this the court concluded, as quoted supra, page 8, that Congress intended the transaction to be considered separate and apart from the "boot" received in determining whether it met the nonrecognition provisions—thus confirming its like conclusion as to the interpretation of § 112(c)(1). In the instant case the court below expressly referred to this determination in the *Howard* case (R. 64) and refused to follow it. Instead the court below assumed that Congress accepted the potentialities

of tax evasion (converting paper losses into tax losses by injecting a trifling amount of cash) which attend the Commissioner's argument (R. 65).

The *Howard* decision accords with every other decision of which we are aware, which involves the disregard of boot in testing the applicability of provisions for limited recognition of gain. These decisions include *First Seattle D. H. Nat. Bank* v. *Commissioner of Int. Rev.* (9 Cir. 1935) 77 F.2d 45, 47-49; *Elizabeth Bruce* (1934) 30 B.T.A. 80, 82-83; *Luther Bonham* (1936) 33 B.T.A. 1100, 1104 (relied on by the Tax Court in the instant case); and *R. C. Love* (1939) 39 B.T.A. 172, 180. In disputing *Howard,* the decision below disputes these other decisions also.

2. The decision below is erroneous:

a. The decision contravenes the plain and literal reading of the statute. The words as written are the expressed intent of Congress (*United States* v. *Mo. Pac. R. Co.* (1929) 278 U.S. 269, 278). As noted above, § 112(c)(1) plainly declares that:

> "If an exchange would be within the provisions of subsection (b) • • (3) • • of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph • • to be received without the recognition of gain, but also of • • money, then the gain • • to the recipient shall be recognized, but in an amount not in excess of • • such money • •."

And § 112(b)(3) provides:

> "No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganiza-

> tion are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization."

Here, "if it were not for the fact that" the property received in exchange consisted not only of voting stock of Foremost but also of money, the transaction would have been not only a stock-solely-for-stock exchange (§112(b)(3)), but also a reorganization as mentioned in § 112(b)(3) and as defined in § 112(g)(1)(B). Nothing in § 112(c)(1) warrants reading the "if it were not for the fact" clause as applying to the "solely for stock" postulate but not to the "reorganization" postulate. The literal reading of the words of Congress dictates the contrary.

In reasoning to its conclusion, the court below falls into several errors of statement. For example, the decision indicates as a necessary part of the taxpayer's and the Tax Court's position, that "(B)-type" reorganizations (i.e., reorganizations as defined in § 112(g)(1)(B), Appx. A, infra, p. ii) "can hypothetically exist notwithstanding boot" (R. 63). On the contrary, the taxpayer's and the Tax Court's position explicitly refers to transactions which *are not* "(B)-type" reorganizations because boot is present, but which *would be* (B)-type reorganizations if the boot were not present—and such is the transaction in the instant case. Similarly, the court's summation concluding that "§ 112(c) cannot operate to render a stock-plus-boot acquisition a (B) or (C) reorganization through a disregard of the existence of boot" (R. 66) reflects the same distortion; it has never been contended that the transaction *is* a (B)-type reorganization (whereupon there would

be *no* gain immediately recognized), but only that if the existence of boot is disregarded as § 112(c) hypothesizes, the transaction *would have been* a stock-solely-for-stock reorganization.

This non sequitur is the essence of the Commissioner's position. The argument comes down to this: the transaction as it stands is not a "reorganization" because of the money ingredient; therefore the transaction as it stands does not come within the total tax deferment of § 112(b)(3); therefore the transaction as it stands does not come within the partial tax deferment of § 112(c)(1) because of the money ingredient. This is a perversion of the plain language of § 112(c)(1).

b. The decision states a rule of construction which admittedly would necessarily apply to the identical language of § 112(e), the counterpart of § 112(c) dealing with losses. As shown above, such construction is contrary to the intent of Congress as expressly stated in the Committee report showing the reason for this provision—all as emphasized by the court in *Howard*, supra.

c. The decision contravenes the basic policy of the income tax structure, which is to tax immediately the gain from sales or exchanges of property to the extent of the receipt of money or property other than in kind, and to postpone taxation of the property received in kind until it should become the subject of some later taxable transaction. This is the manifest policy which runs throughout §§ 112(a), 112(b), 112(c) and 112(e).

The reorganization provisions are "tax-*deferring*, rather than tax-*exempting*, provisions" (Paul, Studies in Federal Taxation, Third Series, 1940, p. 4). They "are deemed

by Congress to be transitional, continuing transactions which are not sufficiently 'closed' to justify *economically* • • the imposition of capital gains tax at the immediate moment." As to other types of income in the form of the equivalent of cash, there is an immediate imposition of tax; but "the legislative intent in the reorganization provisions is to permit nothing more than a postponement of tax incidence to some future time when there is more than a 'mere change in the form of ownership'" (id. pp. 4-5).

This policy fits the instant case. The taxpayer has paid the tax on the cash component. On the voting stock component, Congress has postponed the imposition of the tax until the taxpayer sells or otherwise disposes of the stock in some way so as to convert any paper profit into an actual profit. When that time comes, Turnbow will be taxable on the gain eventually realized. There is no tax avoidance.

The Congressional committee reports express both policy and effect. Ushering in the original forerunner of § 112(c)(1), House Report 1432 of the 67th Congress, 4th Session (C.B. 1939-1, Pt. 2, p. 845),[4] after exemplifying the limited tax on a stock-for-stock-plus-cash exchange, stated:

> "The reason for this is that the profit, so far as it is contained in the new stock received, had not yet been realized, and therefore should not be taxed until the new stock is sold or in some way disposed of so that the profit will be actually realized."

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[4]Approved by the Senate without change (S.Rept. 1113, 67th Cong., 4th Sess. (C.B. 1939-1, Pt. 2, p. 845)).

And when the 1939 Code was adopted, the House Committee thus explained its operation (H.Rept. 855, 76th Cong., 1st Sess., C.B. 1939-2, p. 518):

> "It has long been the policy in our income tax law to give due consideration to the exigencies of business in connection with corporate reorganizations by postponing, in certain specifically described instances, the recognition of gain realized in such transactions. In general, if gain is realized in such a transaction, nonrecognition of the *entire* gain is allowed only where under the specifically defined circumstances, the taxpayer transfers property and receives in exchange therefor *stock or securities in a corporation which is a party to the reorganization.* If, *in addition to such stock* [i.e., stock in a corporation which is a party to a reorganization] or securities, *other property or money is received,* gain is recognized to the extent of such other property or money" (emphasis added).

These are plain expressions of the intent of Congress. They confirm the literal language of the statute.

3. The decision below presents continuing questions of importance under present tax laws.

The provisions of §§ 356(a) and 356(c) of the Internal Revenue Code of 1954 (Appx. A, infra, p. iii), which correspond to §§ 112(c)(1) and 112(e) of the 1939 Code, contain substantially the same language and certainly the same pattern. The Commissioner's reiteration in the court below of his position which the Court of Appeals for the Seventh Circuit had rejected in the *Howard* case demonstrates that he will continue to oppose *Howard* and *Bonham* until this Court resolves the conflict. Uncertainties inherited from the decision below vis-á-vis the *Howard* and

Bonham decisions must attach to the 1954 Code provisions as well as to the 1939 Code. The ready means of converting a paper loss into a tax loss by injecting a nominal amount of cash, which would flow from the interpretation adopted by the court below, may seriously affect the national revenue if its decision is allowed to stand.

The uncertainties and conflicts outlined above may well affect a great number of taxpayers and transactions, both past and future. Such uncertainties will continue to exist until resolved by this Court. Clear understanding is essential both to the security of business transactions and to the administration of the revenue laws.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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(Appendices Follow.)

Appendix A

Internal Revenue Code of 1939:

"Sec. 112. *Recognition of gain or loss—*

(a) *General rule.* Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges solely in kind—*

• • • • • •

(3) *Stock for stock on reorganization.* No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

• • • • • •

(c) *Gain from exchanges not solely in kind.* (1) If an exchange would be within the provisions of subsection (b) (1), (2), (3), or (5), or within the provisions of subsection (1), of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph or by subsection (1) to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

• • • • • •

(e) *Loss from exchanges not solely in kind.* If an exchange would be within the provisions of subsection (b) (1) to (5), inclusive, or (10), or within the

provisions of subsection (l), of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized.

• • • • •

(g) *Definition of reorganization.* As used in this section (other than subsection (b) (10) and subsection (l)) and in section 113 (other than subsection (a) (22))—

(1) The term 'reorganization' means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation, or (C) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of substantially all the properties of another corporation, but in determining whether the exchange is solely for voting stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded, or (D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its shareholders or both are in control of the corporation to which the assets are transferred, or (E) a recapitalization, or (F) a mere change in identity, form, or place of organization, however effected.

(2) The term 'a party to a reorganization' includes a corporation resulting from a reorganization

and includes both corporations in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another."

53 Stat. 37-40.

Internal Revenue Code of 1954:

"Sec. 356. *Receipt of additional consideration*

(a) *Gain on exchanges.*—

(1) *Recognition of gain.*—If—

(A) section 354 or 355 would apply to an exchange but for the fact that

(B) the property received in the exchange consists not only of property permitted by section 354 or 355 to be received without the recognition of gain but also of other property or money,

then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

• • • • •

(c) *Loss.*—If—

(1) section 354 would apply to an exchange, or section 355 would apply to an exchange or distribution, but for the fact that

(2) the property received in the exchange or distribution consists not only of property permitted by section 354 or 355 to be received without the recognition of gain or loss, but also of other property or money,

then no loss from the exchange or distribution shall be recognized."

68A Stat. 115-116.

Appendix B

[R. 29] In the Tax Court of the United States.

GROVER D. TURNBOW AND RUTH H. TURNBOW, PETITIONERS, *v.* COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

Docket No. 69429. Filed June 12, 1959.

Petitioner, who owned all of the stock of Supply, exchanged all of such stock for shares of stock of Foremost Dairies, Inc., and $3,000,000. He reported gain limited to $3,000,000, less expenses, under section 112(c)(1), 1939 Code. Respondent determined that gain in excess of $3,000,000 was taxable because section 112(c)(1) was not applicable. *Held,* the provisions of section 112(c)(1) are applicable and petitioner's gain is recognized but only in an amount which does not exceed the cash payment.

M. W. Dobrzensky, Esq., and *S. H. Dobrzensky, Esq.,* for the petitioners.

Nat. F. Richardson, Esq., for the respondent.

The Commissioner determined deficiencies in income tax for the taxable years 1952 and 1953 in the amounts of $264,037.43 and $14,786.26, respectively. The question is whether or not section 112(c)(1), 1939 Code, applies to a transaction in which petitioner received cash and stock in an acquiring corporation in exchange for all of the stock in another corporation, which became a subsidiary of [R. 30] the acquiring corporation, so that the taxable gain to be recognized is limited to the amount of cash received.

FINDINGS OF FACT.

The petitioners, residents of San Francisco, California, filed joint income tax returns for the taxable years with the collector of internal revenue for the first district of California. Since the issue to be decided relates only to Grover D. Turnbow, he is referred to hereinafter as the petitioner.

Petitioner owned all of the outstanding stock of International Dairy Supply Co. (a Nevada corporation) and International Dairy Engineering Co. (a California corporation). International Dairy Supply Co. (a Nevada corporation) owned 60 per cent of the stock of Diamond Dairy, Inc., and a group of individuals represented by petitioner owned the remaining 40 per cent of the stock of Diamond Dairy, Inc.

Foremost Dairies, Inc., a New York corporation (hereinafter called Foremost), which has its principal place of business in Jacksonville, Florida, is engaged in the business of processing and distributing milk, cream, and other dairy products.

International Dairy Supply Co. (hereinafter called Supply[1]) had, and still has, its principal office in San Francisco. The main part of its business was furnishing reconstituted milk and [R. 31] milk products to the Armed Forces of the United States, located outside the country, under contracts with the United States. Supply prepared dehydrated milk and milk products in this country and shipped such products to plants, which it operated in foreign countries, where the dehydrated milk and milk

[1]The parties also refer to this corporation as International.

products were converted into liquid milk, chocolate drinks, ice cream, and similar products. Since it began business, 95 per cent of Supply's gross income has been derived from sources other than sources within the United States. In 1952, Supply was a party to a contract with the United States which had been executed in 1948 and which was a continuing contract in good standing. Supply also had a contract with the United States to furnish milk products to the Armed Forces in the Far East Command.

In 1952, there was only one class of stock of Supply issued, namely, voting capital stock. There were 5,000 shares outstanding, all of which were owned by Grover D. Turnbow.

In 1952, International Dairy Engineering Co. (hereinafter called Engineering) was engaged in constructing a plant at Atwater, California. Its total outstanding stock consisted of 100 shares, which were owned by Turnbow.

In 1952, the outstanding capital stock of Diamond Dairy, Inc. (hereinafter called Diamond), consisted of 25,000 shares, of which Supply owned 15,000 shares, 60 per cent, and individuals owned 10,000 shares, 40 per cent.

[R. 32] In 1951, Foremost and Turnbow began negotiations and entered into an agreement under which Foremost was to acquire all of the stock of the three corporations above named in what was intended to be a tax-free reorganization. Upon completion of preliminary matters in the early part of 1952, a supplemental agreement, called Amendatory Agreement, was executed by Foremost and Turnbow on February 11, 1952. The amendatory agreement is incorporated herein by this reference. It included, *inter alia*, the reorganization plan.

Under the reorganization plan the following was to be done: (1) Foremost was to acquire from Turnbow all of the capital stock of Supply (5,000 shares), and Turnbow was to receive in exchange 82,375 shares of the common stock of Foremost, plus $3,000,000. Supply was thereby to become a wholly owned subsidiary of Foremost; it was to continue in the operation of its business. (2) Foremost was to acquire from Turnbow all of the outstanding capital stock of International Dairy Engineering Co. (100 shares), and Turnbow was to receive in exchange 60,000 shares of the common stock of Foremost. International Engineering was thereby to become a wholly owned subsidiary of Foremost, and it was to continue in the operation of its business. (3) Under the first exchange of stock, Foremost would gain control of 60 per cent of the capital stock of Diamond Dairy, Inc., which was owned by Supply. Having acquired control of Diamond, Foremost, pursuant to the plan of reorganization, was to acquire the minority stock of [R. 33] Diamond, 10,000 shares, by giving 10,000 shares of Foremost common stock in exchange for 10,000 shares of capital stock of Diamond, which Turnbow agreed to deliver. Neither Supply, Engineering, Diamond, nor Foremost was to make any distribution to its respective shareholders in pursuance of the plan of reorganization, or otherwise.

It was contemplated, under the reorganization plan, that the number of directors of Supply and Engineering would be changed so that Turnbow would maintain three directors thereon and Foremost would elect three Directors; that Supply would create an executive committee consisting of three members, two of which would be nominated

by Foremost; that Turnbow would be the president and general manager of Supply and of Engineering, and that Turnbow's nominee would be president and/or general manager of Diamond; that Turnbow's salary would be in the same amount as the salary of the president of Foremost; that the president of Foremost might become the vice president of Supply and of Engineering, and the chairman of the executive committee of each company; that Turnbow would become a member of the board of directors and of the executive committee of Foremost, and would have the right to nominate two directors, in addition to himself, to Foremost's board of directors; that Turnbow would be elected chairman of Foremost's executive committee; and that Turnbow would execute a formal agreement with Foremost not to compete with either Supply, Engineering, or Foremost in the type of business [R. 34] carried on by each, other than the business of farming, cattle raising, or the farm production of milk. Furthermore, it was contemplated by the parties that there would be two divisions of the business of Foremost, the Eastern division, and the Western and International division; and that Turnbow would be known as the general manager of the Western and International division, and Paul E. Reinhold (the president of Foremost) would be known as the general manager of the Eastern division.

The closing date under the 1952 agreement was March 3, 1952. Prior to the closing date Turnbow was to do the following things: He was to purchase a ranch and certain personal property for cash from Engineering, and he was to convey all title to a patent application to Engineering. Also, he was to pay $500,000 to Engineering

as a capital contribution, and it was agreed that the plant which Engineering was constructing at Atwater would cost in excess of $600,000, and would be completed, substantially, by April 15, 1952. Turnbow was, further, to purchase for cash from Supply certain notes receivable of three stockholders of Diamond for $61,142, and a note of a Dr. Kempf for $3,150.

The terms of the agreement of February 11, 1952, were carried out.

On March 3, 1952, the exchange of the stock of Supply for stock of Foremost was consummated, and Turnbow received 82,375 shares of the common stock of Foremost (a minority interest) in exchange for all of the capital stock of Supply. Turnbow [R. 35] also received cash from Foremost in the amount of $3,000,000. Since his expenses in connection with the exchange were $15,007.23, the net amount of the cash he received was $2,984,992.77.

On March 3, 1952, the 82,375 shares of common stock of Foremost had a fair market value of $15 per share.

In the exchange of the stock of Supply, Foremost acquired all of the issued and outstanding shares of stock of Supply, of all classes. In the exchange, petitioner acquired only the 82,375 shares of common stock of Foremost and cash in the amount of $3,000,000 ("boot"), and Foremost acquired only all of the issued and outstanding shares of the voting capital stock of Supply.

In the income tax return of the petitioner for 1952, he reported long-term capital gain from the above-described transaction in the amount of $2,984,992.77, under the provision of sections 112(b)(3) and 112(c)(1).

The Commissioner's determination was as follows:

In 1952 you exchanged 5,000 shares of International Dairy Supply Company capital stock for $3,000,000.00 in cash and 82,375 shares of capital stock of Foremost Dairies, Inc. You determined that the gain to be recognized was limited to the amount of cash received. In your return you reported a gain of $2,984,992.77 ($3,000,000.00 less $15,007.23 expense of exchange). It is held that the entire gain realized upon the exchange constituted [R. 36] taxable income. The adjustment to the income reported in your return is computed as follows:

Amount received on exchange:		
Cash		$3,000,000.00
82,375 shares of Foremost Dairies, Inc. valued at $15.00 a share		1,235,625.00
Total received		$4,235,625.00
Less: Basis of stock exchanged	$50,000.00	
Expenses per return	20,981.80	
Add'l. legal fees allowed	951.26	
		71,933.06
Gain recognized		$4,163,691.94
Gain reported		2,984,992.77
Additional gain recognized		$1,178,699.17
Adjustment to income—50 per cent		$589,349.59

OPINION.

HARRON, *Judge:* Petitioner owned all of the outstanding stock of Supply, which was voting stock. In 1952, he received in exchange for all of his stock in Supply 82,375 shares of common stock of Foremost and $3,000,000 in cash, so-called "boot." The question before us is limited to whether the provisions of section 112(c)(1) of the 1939 Code[2] [R. 37] apply to the transaction. Respondent has determined that section 112(c)(1) does not apply, and that therefore, the entire gain is taxable under section 112(a).

Petitioner contends that, in considering whether section 112(c)(1) applies to the transaction, it is necessary and proper to look to section 112(b)(3)[3] *after omitting* the cash payment involved in the transaction. Respondent contends that there must be a qualifying reorganization within

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[2]SEC. 112(c). GAIN FROM EXCHANGES NOT SOLELY IN KIND.—

(1) If an exchange would be within the provisions of subsection (b) (1), (2), (3), or (5), or within the provisions of subsection (l) of this section if it were not for the fact that, the property received in exchange consists not only of property permitted by such paragraph or by subsection (l) to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

[3]SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) GENERAL RULE.—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) EXCHANGES SOLELY IN KIND.—

* * * * * * *

(3) STOCK FOR STOCK ON REORGANIZATION.—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

the meaning of section 112(g)(1)(B)[4] before section 112(c)(1) can come into play insofar as section 112(c)(1) refers to an exchange within the provisions of section 112(b)(3).

[R. 38] Subsection (b) of section 112 allows various exceptions from subsection (a), which states the general rule that the entire amount of the gain shall be recognized upon the sale or exchange of property. Subsection (b) deals with exchanges solely in kind, whereas subsection (c) deals with the treatment of gain from exchanges which are not solely in kind, but only *if* an exchange *would be within* (1), (2), (3), or (5), *if it were not for the fact that the property received in exchange consists* not only of property permitted by (1), or (2), or (3), or (5), but *also of other property or money.* Directing our attention to section 112(b)(3), it is noted that among the requirements contained therein is the specification that the property involved must be stock or securities which is exchanged *solely* for stock or securities. Both of the sections involved here, subsection (b)(3) and subsection (c)(1), are provisions of long standing which were reenacted in the successive revenue acts which preceded the 1939 Code. In both the regulations of the Commissioner and in this Court's interpretation of section 112(c)(1), it has been understood that in order to give effect to the provisions of section 112(c)(1) the *method* to be followed is first to

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[4]SEC. 112(g) DEFINITION OF REORGANIZATION.—As used in this section • • •—

(1) The term "reorganization" means • • •, or (B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation, • • •

omit the item of cash (or other property) from the transaction and then to determine whether the exchange *would be* within subsection (b)(3). Otherwise, section 112(c)(1) would have no meaning in the context of its references to particular subsections of section 112(b).

[R. 39] In *Luther Bonham,* 33 B.T.A. 1100, 1103-1104 (1936), this Court concluded that the method of applying the statute was as follows:

"It is necessary therefore to determine whether or not the exchange of • • • stock for • • • stock *would be* within the provisions of subsection (b)(3) *if the item of cash had been omitted* and only • • • stock had been received in exchange for • • • stock." [Italics supplied.]

In *Howard v. Commissioner,* 238 F. 2d 943, 948 (1956), reversing 24 T.C. 792, on the basis of a question which was not reached by this Court, the following was stated:

"Thus we may conclude that, in determining when these so-called 'boot' provisions apply, Congress intended that the transaction is to be considered separately and apart from the 'boot' received in determining whether it meets the nonrecognition provisions. If the transaction, absent the 'other property or money,' fulfills the requirements of section 112(b)(3), then gain is to be recognized to the extent that 'boot' is received.

In the instant case, *but for* the cash received in exchange for • • • common stock of Binkley, the transaction would have met the 'solely' requirement of section 112(g)(1)(B) and fallen within the scope of section 112(b)(3). To the extent that 'boot' was received, gain would be recognized under our interpretation of section 112(c)(1). • • •"

The view expressed in *Howard v. Commissioner, supra,* corresponds with the opinion which was expressed by this Court in the *Bonham* case. Our [R. 40] problem here is whether we should adhere to our understanding of the *method* to be followed in determining whether section 112(c)(1) applies in the exchange of stock solely for stock, plus money.

Consideration has been given to the respondent's regulation, Regs. 118, sec. 39.112(g)–4 (issued September 26, 1953, and applicable to taxable years beginning after December 31, 1951), which is set forth in the margin.[5] Regs. 111, sec. 29.112(g)-4 [R. 41] (issued by respondent in October 1943 and applicable to taxable years beginning after December 31, 1941), contain provisions which are identical with Regs. 118, sec. 39.112(g)-4. The provisions of section

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[5]Sec. 39.112(g)-4 *Exchanges in reorganization for stock or securities and other property or money.* (a) If in an exchange of stock or securities in a corporation a party to a reorganization, in pursuance of the plan of reorganization, for stock or securities in the same corporation or in another corporation a party to the reorganization, there is received by the taxpayer other property (not permitted to be received without the recognition of gain) or money, then

(1) As provided in section 112(c)(1), the gain, if any, to the taxpayer will be recognized in an amount not in excess of the sum of money and the fair market value of the other property, but

(2) The loss, if any, to the taxpayer from such an exchange is not to be recognized to any extent (see section 112(c)).

(b) The application of paragraph (a) of this section may be illustrated by the following example:

Example. A, in connection with a reorganization, in 1952, exchanges a share of stock in the X Corporation purchased in 1929 at a cost of $100 for a share of stock of the Y Corporation (a party to the reorganization), which has a fair market value of $90, plus $20 in cash. The gain from the transaction is $10 and is recognized and taxed as a gain from the exchange of property. But see section 117. However, if the share of stock received had a fair market value of $70, the loss from the transaction of $10 would not be recognized.

112(c)(1) of the 1939 Code were reenacted in substantially identical language in section 351(b) of the 1954 Code, and respondent's regulations promulgated under the 1954 Code, section 1.351-2(a) restate in substantially identical language what was stated in Regs. 111, sec. 29.112(g)-4, and Regs. 118, sec. 39.112(g)-4.

Thus, there has been a long-standing and continuous construction of section 112(c)(1) (and the corresponding section in the earlier revenue acts) which has remained unchanged over the years in the face of the several reenactments of the statutory provision, as well as the amendment in the 1934 Act of section 112(g)(1)(B), when there was introduced into subsection (g)(1)(B) the word "solely," in harmony with the provisions of subsections (b)(2), (b)(3), (b)(4), and (b)(5) which also contained the word "solely," and contained "solely" for many years. The respondent's regulations, therefore, are deemed to have received the approval of Congress. *Helvering v. Winmill*, 305 U.S. 79; *Lykes v. United States*, 343 U.S. 118. Respondent has not offered any explanation for his departure in this case from his long-standing interpretation of section 112(c)(1) set forth in his regulations.

In this circumstance, and since this Court's view of the *method* to be followed in applying the pro-[R. 42] visions of section 112(c)(1) is in accord with the respondent's longstanding regulations, we do not find cause for changing our construction of section 112(c)(1), and in this case we conclude that it should be followed.

The respondent's error is that he has seen fit here not to omit the item of cash in determining whether the transaction of petitioner and Foremost involved an exchange

of the stock of Supply solely for stock of Foremost within the provisions of section 112(b)(3).

Accordingly it is held, that *but for* the cash received by petitioner in the transaction involving the exchange of all of the stock of Supply for part of the stock of Foremost, the exchange would have met the "solely" requirement of section 112(g)(1)(B) and fallen within section 112(b)(3). *Howard v. Commissioner, supra* at 948. Therefore, under section 112(c)(1) the gain to petitioner may not be recognized in an amount in excess of $2,984,992.77, which is the net amount of $3,000,000 less allowable expenses.

Recomputations are required under Rule 50 because of concessions or abandonment of the parties in respect to other adjustments.

Decision will be entered under Rule 50.

[R. 43] Tax Court of the United States
Washington

Docket No. 69,429

GROVER D. TURNBOW and RUTH H. TURNBOW,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determinations of the Court, as set forth in its Findings of Fact and Opinion filed June 12, 1959, the respondent has filed recomputations under Rule 50, with which the petitioners agree. Accordingly, it is

Ordered and Decided: That there are deficiencies in income taxes for the taxable years 1952 and 1953 in the amounts of $5,694.30 and $13,404.73, respectively.

[Seal] Marion J. Harron,
Judge.

Entered August 31, 1959. Served September 1, 1959.

[R. 56] United States Court of Appeals
for the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

GROVER D. TURNBOW and RUTH H. TURNBOW,
Respondents.

No. 16,775
Dec. 5, 1960

Upon Petition to Review a Decision of The
Tax Court of the United States

Before: MERRILL and KOELSCH, Circuit Judges, and BOWEN, District Judge.

MERRILL, Circuit Judge:

This case presents the following question: whether gain realized by a taxpayer upon the transfer of his stock in a wholly owned corporation in consideration for voting stock in another corporation plus cash is recognizable in its entirety or only to the extent of the cash received. The Tax Court, following Howard vs. Commissioner of Internal Revenue, 7 Cir., 1956, 238 F.2d 943, has ruled that the gain is recognizable only to the extent of the cash received. Grover D. Turnbow, 32 T.C. 646. We have concluded that this was error and that the gain is recognizable in its entirety.

The taxpayer, Turnbow, was the sole stockholder of International Dairy Supply Company, a Nevada corporation which had its principal place of business in San Fran-

cisco, California. In 1952, the taxpayer transferred his stock in that company to Foremost Dairies, Inc., a New York corporation which had its principal place of business in Jacksonville, Florida. This transfer was in exchange for 82,375 shares of the common stock of Fore-[R. 57]most and $3,000,000.00 cash, so-called "boot." The Foremost shares were of a value of $1,235,625.00. Thus the shares constituted 29% of the total consideration received, while the boot constituted 71%.

The taxpayer reported a capital gain on the transaction limited to the $3,000,000.00 cash boot, less expenses which by agreement he had undertaken to assume. The Commissioner determined that the entire gain on the transaction was taxable, establishing that gain at $4,163,691.94. Tax deficiencies for the years 1952 and 1953 in the amounts, respectively, of $264,037.43 and $14,786.26 were determined.

The taxpayer petitioned the Tax Court for review. That court held that gain on the transaction should be limited to the cash boot. The deficiencies were disallowed. The Commissioner has petitioned this court for review.

The problem presented involves construction of § 112 of the Internal Revenue Code of 1939, which deals with recognition of gain or loss.

Section 112(a) sets forth the general rule that "upon the sale or exchange of property the entire amount of gain or loss * * * shall be recognized, except as hereinafter provided in this section."

Among the exceptions specified, § 112(b) deals with exchanges solely in kind, and § 112(b)(3) deals with ex-

changes of stock for stock on reorganization. It provides:

> "No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization."

The term "reorganization," as used in § 112(b)(3), is defined in § 112(g)(1), which, as amended in 1943, provides:

> "The term 'reorganization' means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation, or (C) the acquisition by one corporation, in exchange solely for all or a part of its voting [R. 58] stock, or substantially all the properties of another corporation, but in determining whether the exchange is solely for voting stock the assumption by the acquiring corporation or a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded, or (D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its shareholders or both are in control of the corporation to which the assets are transferred, or (E) a recapitalization, or (F) a mere change in identity, form, or place of organization, however, effected."

In this case we are concerned with the definition set forth in Clause (B) of § 112(g)(1). Our discussion also deals with the definition set forth in Clause (C). Today

these types of reorganization are known to the tax bar as (B) and (C) reorganizations and we shall take advantage of this terminology.

Section 112(c) is the section upon which the taxpayer relies for his right to limit recognition of gain to the cash boot. As amended in 1943, § 112(c)(1) provides:

> "If an exchange would be within the provisions of subsection (b) (1), (2), (3), or (5), or within the provisions of subsection (1), of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph or by subsection (1) to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property."

The dispute before us is as to the method to be followed in applying § 112(c) to the facts of a case. The Tax Court purported to follow its earlier decision upon this problem in Luther Bonham, 1936, 33 B.T.A. 1100, 1103-1104. It quoted that opinion (supplying its own emphasis) as follows:

> "It is necessary therefore to determine whether or not the exchange of * * * stock for * * * stock *would be* within the provisions of subsection (b)(3) *if the item of cash had been* [R. 59] *omitted* and only * * * stock had been received in exchange for * * * stock."

Howard vs. Commissioner of Internal Revenue, supra at page 948, was also quoted to the following effect:

> "In the instant case, *but for* the cash received in exchange for * * * common stock of Binkley, the trans-

> action would have met the 'solely' requirement of section 112(g)(1)(B) and fallen within the scope of section 112(b)(3). To the extent that 'boot' was received, gain would be recognized under our interpretation of section 112(c)(1)."

Applying this method to the case at bar, the taxpayer reasons: but for the cash received, the transaction—solely stock for stock—would have met the "solely" requirements of both §§ 112(b)(3) and 112(g)(1)(B) and fallen within the nonrecognition provision of § 112(b)(3). Therefore, he says, under § 112(c) the gain to be recognized is limited to the amount of the cash received.

The Commissioner contends that § 112(b)(3) requires an actual and not a hypothetical reorganization before nonrecognition can result; that petitioner's method assumes the absence of boot not only to determine whether § 112(b)(3) would apply but also to determine whether the §112(g)(1)(B) definition would apply; that this does violence to § 112(b)(3), which expressly contemplates the existence of a reorganization.

The method of applying § 112(c), advocated by the Commissioner, is to ascertain first whether a reorganization exists under § 112(g)(1). If it does, then and only then can the nonrecognition provisions of § 112(b)(3) become applicable. If it does not, § 112(b)(3) cannot apply. Only when § 112(b)(3) applies, can § 112(c) operate to modify its consequences.

Applying this method to the case at bar, the Commissioner reasons that, since the presence of boot precludes a (B) reorganization, § 112(b)(3) cannot apply and the gain is subject to taxation under § 112(a). Under the Com-

missioner's construction, (B) and (C) reorganizations are forever excluded from the operation of § 112(c). The other types of reorganizations specified in § 112(g)(1), however, do remain subject to the operation of § 112(c).

[R. 60] Upon this dispute, legislative history supports the Commissioner's position.

Prior to 1934, there were no (B) or (C) reorganizations as such.[1] Section 112(i) of the Revenue Act of 1932 (the prior analogous section to § 112(g)(1) of the 1934 Act) read in pertinent part:

> "The term 'reorganization' means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation)."

The provisions of §§ 112(b)(3) and 112(c), however, existed in substantially their present form.

The reasons for the 1934 amendment of § 112(g)(1) are clearly disclosed by congressional reports and discussion. The House Ways and Means Committee Report, H. Rep. No. 704, 73d Congress, 2d Session 13 (1934) states:

> "The reorganization provisions have been in effect for many years, having been adopted in substantially their present form in 1924. They state in detail how each step of a reorganization should be treated for tax purposes. The policy was adopted of permitting reorganizations to take a wide variety of forms, with-

[1] Even the 1934 amendment did not separate (B) and (C) reorganizations. Both were dealt with under Clause (B). It was not until the Internal Revenue Code of 1939 that the separation occurred which has given rise to today's terminology.

out income-tax liability. As a result, astute lawyers frequently attempted, especially during the prosperous years, to take advantage of these provisions by arranging in the technical form of a reorganization, within the statutory definition, what were really sales."

A letter from the Secretary of the Treasury, which appears in the Congressional Record, 78 Cong. Rec. 2512 (1934) states:

"Exchanges and reorganizations. The Treasury regards it as desirable that business readjustments be permitted without tax consequences in cases where the stockholders in the enter-[R. 61]prise are retaining their interests without the receipt of cash and the essential continuity of the business is being preserved. On the other hand, the Treasury has suffered a considerable loss of revenue in recent years through the adroitness of attorneys in planning sales in such a way as to come within the scope of the reorganization provisions. The bill revises the definition of reorganization in order to eliminate serious loopholes in this provision, while legitimate exchanges and reorganizations may still be carried out without the realization of gain or loss. In the opinion of the Department, a considerable saving in revenue will result from these amendments without the injurious effects to business which would have been caused by a complete elimination of these provisions."

A subcommittee of the House Ways and Means Committee, studying the revision of the revenue act, was sufficiently exercised over avoidance practices to give serious consideration to the advisability of eliminating completely the provisions governing reorganization exchanges. H. Rep., December 4, 1933, 73d Congress, 2d Session, 8-9

(1933). However, the House Ways and Means Committee, in its report, stated:

> "The committee decided that, under present conditions, the wiser policy is to amend the provisions drastically to stop the known cases of tax avoidance, rather than to eliminate the sections completely." H. Rep. No. 704, 73d Congress, 2d Session, 13 (1934).

The House committee's solution was to eliminate from the definition of reorganization, as it then appeared in Clause (A), the parenthetical phrase following the words "merger or consolidation."

Had this solution been adopted, there would have been no (B) or (C) reorganizations and § 112(c) obviously could have no reference to such transactions.

The Senate Finance Committee reported, S.Rep. No.558, 73d Congress, 2d Session, 16 (1934):

> "Your committee is in complete agreement with the purposes of the House bill which aim at tax avoidance schemes in [R. 62] this connection. However, some modifications are recommended in order to bring about a more uniform application of the provisions in all 48 of the States. Not all of the States have adopted statutes providing for mergers or consolidations; and, moreover, a corporation of one State cannot ordinarily merge with a corporation of another State. The committee believes that it is desirable to permit reorganizations in such cases, with restrictions designed to prevent tax avoidance. Consequently, the committee recommends the insertion in the House bill of an addition to the definition of the term 'reorganization' as follows: * * *"

Then follows the Clause (B) definition which was eventually incorporated into § 112(g)(1) of the 1934 act.

Emphasizing its views that the tax avoidance problems would be met, the report states at page 17:

> "It will be noted that the proposed amendment requires that * * * the acquisition, whether of stock or of substantially all the properties, must be in exchange solely for the voting stock of the acquiring corporation."

It is clear from this history that, with specific abuses in mind, Congress sought to eliminate them by requiring that, for an acquisition to qualify for the tax advantages of a reorganization, it must be in exchange solely for voting stock.

With reference to this requirement the Supreme Court has stated in Helvering vs. Southwest Consolidated Corporation, 1941, 315 U.S. 194, 198:

> "But clause B of § 112(g)(1) of the 1934 Act effects an important change as respects transactions whereby one corporation acquires substantially all of the assets of another. See S. Rep. No. 558, 73d Cong., 2d Sess., Committee Reports, Revenue Acts 1913-1938, pp. 598-599. The continuity of interest test is made much stricter. See Paul, Studies in Federal Taxation (3d Series), pp. 36-41. Congress has provided that the assets of the transferor corporation must be acquired in exchange 'solely' for 'voting stock' of the transferee. 'Solely' leaves no leeway. Voting stock plus some other consideration does not meet the statutory requirement. See [R. 63] Hendricks, Developments in the Taxation of Reorganizations, 34 Col. L. Rev. 1198, 1202-1203."

Certainly it could not have been intended by Congress that this result would be frustrated at birth by the already existing provisions of § 112(c); yet such would seem to be the effect of the taxpayer's construction.

The Commissioner's construction seems supported by subsequent congressional action. If (B) reorganizations can hypothetically exist notwithstanding boot, the same would apply to today's (C)-type reorganizations, which also were created by the 1934 amendments.

> "* * * the acquisition by one corporation, in exchange solely for all or a part of its voting stock; * * * of substantially all the properties of another corporation * * *." § 112(g) (1) (B) of the Revenue Act of 1934.

Yet, in 1939, Congress saw fit to amend the definition of (C) reorganizations by providing:

> "* * * but in determining whether the exchange is solely for voting stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded * * *." § 112(g) (1) (C) of the Internal Revenue Code of 1939.

In § 368(a) (2) (B) of the Internal Revenue Code of 1954, the definition was further amended to provide that only 80% of the assets of the acquired corporation need be obtained in exchange for voting stock; that boot could, without defeating reorganization, be the consideration for assets above 80%. Under the taxpayer's construction, neither of these amendments was necessary. That Congress felt it necessary so to amend the section indicates that the Commissioner's construction reflects the true congressional intent and understanding.

The taxpayer refers us to a point emphasized in Howard vs. Commissioner of Internal Revenue, supra. Section 112(e) is the counterpart of § 112(c), the latter dealing with recognition of gains and the former with recognition

of losses. Section 112(e) [R. 64] has remained virtually unchanged since its original enactment as § 203(f) of the Revenue Act of 1924. It provides:

> "If an exchange would be within the provisions of subsection (b) (1) to (5), inclusive, or (10), or within the provisions of subsection (l), of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized."

Howard points out that if the presence of boot results in recognition of gains it likewise results in recognition of losses; that a taxpayer desiring that a loss be recognized might convert what otherwise would be a legitimate reorganization into a sale by the payment of a trifling amount of cash; that such a construction would thus defeat the 1924 legislative intent in enacting § 112(e).

It would appear, however, that Congress in 1934 was aware that attempts might be made under the proposed amendment to secure recognition of losses notwithstanding actual continuity of interest. The House Ways and Means Committee, as we have noted, recommended that the "acquisition" type of transaction (the forerunner of today's (B) and (C) reorganizations) be completely eliminated from the definition of reorganization. At the same time the report stated:

> "Furthermore, the retention of the other reorganization provisions will prevent large losses from being established by bondholders and stockholders who receive securities in a newly reorganized enterprise which are substantially the same as their original in-

vestments." H. Rep. No. 704, 73d Congress, 2d Session, 14 (1934).

Thus it would appear that in the judgment of Congress the danger of tax avoidance (through securing recognition of losses notwithstanding continuity of interest) was avoided by the probability that the acquisitions resulting in loss could be treated as reorganizations under the remaining provisions of § 112(g) (1).[2]

[R. 65] Whether this judgment was sound apparently still remains to be tested. However, Congress would seem to have weighed the desirable features of the proposed amendment (as to gains) against its undesirable potentialities (as to losses). For us to permit the possibility of tax avoidance under § 112(e), to control our construction of § 112(c), would be to overrule the apparent judgment of Congress upon this very question.

The Tax Court opinion in this case points out that the Commissioner's regulations are deemed to have received

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[2]The judgment of Congress would also seem to have taken into consideration the apparent lack of effectiveness of § 112(e) in preventing loss taking in corporation exchange transactions. The report of the subcommittee of the House Ways and Means Committee stated in H. Rep., December 4, 1933, 73d Congress, 2d Session 37-42 (1933):

> "The statute provides that upon sale or exchange of property the entire amount of gain or loss shall be recognized with certain exceptions. The exceptions are the exchange and reorganization provisions already referred to. If a taxpayer desires to take a loss, it is easy to arrange a transaction falling without the exceptions. On the other hand, if it is desired to pay no tax on the gain, the transaction can be so arranged as to come within the exception. In addition, losses from the sale or exchange of stocks and bonds are limited, to a large extent, to gains from such sales or exchanges so in many cases a stock or bond loss, even if recognized, could not be utilized by the taxpayer."

This quote also appears at: Hearings before the House Committee on Ways and Means on the 1934 Revenue Bill, 73d Congress, 2d Session 60 (1934).

the approval of Congress (citing Lykes vs. United States, 1951, 343 U.S. 118; Helvering vs. Winmill, 1938, 305 U.S. 79) and places reliance upon the Commissioner's regulations, 118, § 39.112(g)-4. In our view, this section casts little light on the problem. On the other hand, § 39.112(g)-1 (c) of the regulations lends support to the Commissioner's position. It provides in part:

> "From its context the term 'a party to a reorganization' can only mean a party to a transaction specifically defined as a reorganization by section 112(g). • • • The provisions of the Internal Revenue Code referred to in this paragraph [this includes § 112(c)] are inapplicable unless there is a plan of reorganization. A plan of reorganization must contemplate the bona fide execution of one of the transactions specifically described as a reorganization in section 112(g) [R. 66] and for the bona fide consummation of each of the requisite acts under which nonrecognition of gain is claimed."

We conclude that, if the "solely for voting stock" requirement of (B) and (C) reorganizations is to be given the effect intended by Congress, § 112(c) cannot operate to render a stock-plus-boot acquisition a (B) or (C) reorganization through a disregard of the existence of boot. In the case before us, then, the existence of boot prevents § 112(g) (1) (B) from applying; since no reorganization exists, § 112(b) (3) cannot apply; § 112(c) is then also inapplicable.

Reversed and remanded with instructions that the deficiencies determined by the Commissioner be reexamined in the light of this opinion.

(Endorsed) Opinion Filed Dec. 5, 1960.

Frank H. Schmid, Clerk.

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In the Supreme Court of the United States

OCTOBER TERM, 1960

No. 777

GROVER D. TURNBOW AND RUTH H. TURNBOW,
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT

This case presents the question of whether a gain realized by the taxpayer upon the transfer of his stock in a wholly-owned corporation in consideration for voting stock in another corporation, plus cash, is recognizable in its entirety, as the court of appeals held, or only to the extent of the cash received. The answer depends upon whether a transfer of stock must be in exchange "solely" for voting stock of another corporation in order to qualify as a "reorganization" under Section 112(g)(1)(B) and (b)(3) of the 1939 Code, as those sections expressly require, or whether, as the taxpayer contends, Section 112(c) is to be construed as eliminating that statutory requirement.

In his deficiency notice, the Commissioner determined that the instant exchange failed to qualify as a "reorganization" within the meaning of Section 112(g)(1)(B) and (b)(3) of the 1939 Code in that these provisions of the Code define a "reorganization" as an exchange of stock of an acquired corporation "solely" for voting stock of the acquiring corporation, while here the taxpayer transferred his shares in a wholly-owned corporation for voting stock of the acquiring corporation, plus cash. Hence, the Commissioner determined that Section 112(c)(1), a provision limiting recognition of gain to the extent of the "boot" (cash and other property), was not operative since this subsection comes into play only if an exchange otherwise qualifies as a "reorganization" as defined by Section 112(g)(1)(B). The Tax Court rejected the Commissioner's determination, holding that the gain realized by the taxpayer was recognizable only to the extent of the cash received, $3,000,000, and that the $1,163,691 gain from the stock which taxpayer received was not to be recognized. The Court of Appeals for the Ninth Circuit reversed the Tax Court, holding that an exchange must independently meet the "solely for voting stock" requirement of Section 112(g)(1)(B) (*i.e.*, without resorting to Section 112(c)(1) as grounds for disregarding "boot") as a prerequisite to the application of the latter section. Since the instant exchange failed to qualify, the court of appeals held that the gain realized by the taxpayer was recognizable in its entirety.

We submit that the decision of the Ninth Circuit is correct for the reasons spelled out in its opinion. It is based upon a careful consideration of the legislative history of the relevant Code sections, the full import of the applicable Treasury Regulations involved,[1] and other decisions.[2] We agree, however, that *Howard* v. *Commissioner*, 238 F. 2d 943 (C.A. 7), upon which petitioner relies, conflicts with the instant decision insofar as it holds that Section 112(c)(1) is applicable to an exchange irrespective of whether the transaction independently qualifies as a "reorganization" under Section 112(g)(1)(B) and (b)(3). But it should be pointed out that the facts in *Howard* and those in the instant case differ considerably,[3] and that these are the only two cases involving the precise

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[1] Treasury Regulations 118, Section 39.112(c)-1, 39.112(g)-1, 39.112(g)-2, and 39.112(g)-4.

[2] An examination of the cases cited by the taxpayer (Pet. 10) as allegedly conflicting with the decision below shows that in each, with the exception of *Howard* v. *Commissioner*, 238 F. 2d 943 (C.A. 7), it was either expressly stated or clearly assumed that the exchange qualified as a reorganization or was made pursuant to a plan of reorganization under the statute then in effect. The decision below is in accord with *Helvering* v. *Southwest Consolidated Corp.*, 315 U.S. 194; *Commissioner* v. *Air Reduction Co.*, 130 F. 2d 145 (C.A. 2), certiorari denied, 317 U.S. 681; *Central Kansas T. Co.* v. *Commissioner*, 141 F. 2d 213 (C.A. 10); *Pressed Steel Car Co.* v. *Commissioner*, 152 F. 2d 280 (C.A. 3), affirming 1944 P-H T.C. Memorandum Decisions, ¶ 44,279; *Forrest Hotel Corp.* v. *Fly*, 112 F. Supp. 782 (S.D. Miss.).

[3] In *Howard*, the taxpayers received no cash or other property. The cash paid by the acquiring corporation was paid solely to dissenting stockholders not involved in that litigation.

question as to which there is conflict. Nevertheless, because there is a direct conflict in circuits and the problem is a continuing one,[4] the Commissioner does not oppose the taxpayer's petition for certiorari.

Respectfully submitted.

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MAY 1961.

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[4] Section 112(c)(1), insofar as is pertinent here, has been carried over into the 1954 Code in Section 356(a). The Revised Report published by the Advisory Group on Subchapter C of the Internal Revenue Code of 1954 to accompany H. Rep. No. 4459, 86th Cong., 1st Sess., recommended that Section 356(a) be amended to state explicitly that it "operates only in a transaction which, independent of its provisions, qualifies as a reorganization."

U.S. GOVERNMENT PRINTING OFFICE: 1961

SUPREME COURT, U. S.

Office-Supreme Court, U.S.
FILED
AUG 24 1961
JOHN F. DAVIS, Clerk

In the Supreme Court of the United States

OCTOBER TERM, 1961

No. 60

GROVER D. TURROW and RUTH H. TURROW,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF OF PETITIONERS

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In the Supreme Court
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No. 60

GROVER D. TURNBOW and RUTH H. TURNBOW,
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vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF OF PETITIONERS

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 29-42) are reported at 32 T.C. 646. The opinion of the Court of Appeals (R. 54-64) is reported at 286 F.2d 669.

JURISDICTION

The judgment of the Court of Appeals (R. 65) was entered on December 5, 1960. The petition for a writ of cer-

tiorari was filed March 2, 1961, and was granted May 15, 1961 (R. 66). The jurisdiction of this Court is invoked under section 1254 of Title 28 of the United States Code.

STATUTES INVOLVED

The case directly concerns the application of § 112(c)(1) of the Internal Revenue Code of 1939 (53 Stat. 39), which provides in pertinent part:

> "If an exchange would be within the provisions of subsection (b) * * (3) * * of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph * * to be received without the recognition of gain, but also of * * money, then the gain * * to the recipient shall be recognized, but in an amount not in excess of * * such money * *."[1]

The full text of this statute and the pertinent portions of other statutes referred to herein and in the argument below—namely, §§ 112(a), (b)(3), (d), (e) and (g) of the Internal Revenue Code of 1939 (53 Stat. 37-40) and §§ 356 (a) and (c), 368(a), and 381(a) and (c) of the Internal Revenue Code of 1954 (68A Stat. 115-129 as amended)—are set out in the appendix to this brief. For convenient reference, the appendix also contains excerpts from Treasury regulations which have been discussed in the course of proceedings below.

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[1]These provisions are retained in substantially the same form in the Internal Revenue Code of 1954, § 356(a)(1), 68A Stat. 115, Appx. infra, p. iv.

QUESTION PRESENTED

Whether, under § 112(c)(1) of the Internal Revenue Code of 1939, the gain to a taxpayer who has exchanged all of the voting stock of one corporation for a part of the voting stock of another corporation plus cash is recognized in the year of the transaction only to the extent of the cash, postponing recognition of the gain (if any) on the stock received until it becomes the subject of some later taxable transaction.

STATEMENT OF THE CASE

The facts are not in dispute. As the Tax Court found (R. 36):

The taxpayer[2] owned all 5000 shares of the outstanding stock, all of which was voting stock, of International Dairy Supply Company, a Nevada corporation (hereinafter called "Supply")[3] (R. 30, 31). Supply's business, in the main, was furnishing reconstituted milk and milk products to the Armed Forces of the United States, located outside the country, under contracts with the United States (R. 30-31).

Foremost Dairies, Inc. (hereinafter called "Foremost"), was a New York corporation engaged in the busi-

---

[2]References to the taxpayer in this brief are to Grover D. Turnbow, inasmuch as his wife, Ruth H. Turnbow, is a party only because she filed a joint return with her husband for the taxable year involved.

[3]The taxpayer owned interests in two other corporations, which also entered into the transactions herein described. However, since there is now no issue in any way involving these other interests, reference to them is hereinafter omitted.

ness of processing and distributing milk, cream, and other dairy products (R. 30).

In 1951, Foremost and the taxpayer entered into an agreement under which Foremost was to acquire all of the stock of Supply (R. 32). Upon completion of preliminary negotiations, a supplemental agreement, called "Amendatory Agreement," was executed by Foremost and the taxpayer on February 11, 1952. The Amendatory Agreement included, inter alia, the reorganization plan (R. 32).

Under the reorganization plan Foremost was to acquire from the taxpayer all of the capital stock of Supply, and the taxpayer was to receive in exchange 82,375 shares of the common stock of Foremost (a minority interest), plus $3,000,000. Supply was thereby to become a wholly owned subsidiary of Foremost; it was to continue in the operation of its business. It was not to make any distribution to its shareholders in pursuance of the plan of reorganization or otherwise (R. 32-33).

The reorganization plan also provided for many changes in the management of both Foremost and Supply, with Turnbow to be president and general manager of Supply and also a director and chairman of the executive committee of Foremost and general manager of its Western and International Division, and with the right to name three of Supply's six directors and two of Foremost's directors (R. 33-34).

The terms of the Amendatory Agreement were carried out (R. 34).

On March 3, 1952, the exchange of the stock of Supply for stock of Foremost was consummated, and the taxpayer

received 82,375 shares (then having a fair market value of $15 per share) of the common stock of Foremost and $3,000,000 cash, in exchange for all of the capital stock of Supply. Since his expenses in connection with the exchange were $15,007.23, the net amount of the cash he received was $2,984,992.77 (R. 34-35).

In his 1952 income tax return the taxpayer reported long-term capital gain from the above-described transaction in the amount of $2,984,992.77 (R. 35).

The Commissioner determined that the recognized gain from the transaction should be increased by $1,178,699.17 (the value of the Foremost stock at the date of the exchange less the cost basis of the stock of Supply, with certain adjustments not material here) (R. 35-36).

On the taxpayer's petition for redetermination, under § 272 of the Internal Revenue Code of 1939 (53 Stat. 82), the Tax Court held that the recognized gain on the transaction was limited to the cash "boot" (R. 29-42).

On petition for review under § 7482 of the Internal Revenue Code of 1954, the court below reversed the Tax Court (R. 54-65). Recognizing that the Tax Court had expressly followed the prior decision of the Court of Appeals for the Seventh Circuit in *Howard v. Commissioner of Internal Revenue* (7 Cir. 1956) 238 F.2d 943, and the Tax Court's own prior decision in *Luther Bonham* (1936) 33 B.T.A. 1100, on the identical problem (R. 54, 57), the court below refused to follow those decisions. It held that since the transaction *with the cash included* was not a reorganization under § 112(g)(1)(B), gain on the exchange of the stock as well as to the extent of the cash received

should be recognized. In so ruling it completely disregarded the specific direction in § 112(c)(1), providing that if the exchange would be within the provisions of § 112 (b)(3)—i.e., would qualify as a stock-for-stock reorganization—*if* it were not for the fact that the property received in the exchange consisted not only of stock but also of money,

> "then the gain * * to the recipient shall be recognized, but in an amount not in excess * * of such money * *."

In so ruling the court also adopted an interpretation, directly contrary to that in the *Howard* case, of the provisions of § 112(e) of the 1939 Code (53 Stat. 39; Appx. infra, p. ii), the correlative section dealing with *losses* from exchanges not solely in kind. *Howard* pointed out that the Commissioner's position would permit a taxpayer to escape the application of this provision by adding a nominal amount of cash to a stock-for-stock exchange and thus convert a paper loss into a tax loss. In the instant case, the court below considered that "Congress would seem to have weighed" these "undesirable potentialities" against the interpretation adopted by the court and to have accepted the consequences (R. 63-64).

The admitted effect (R. 64) of the decision is to write into § 112(c)(1) an unexpressed exception, as though that statute read:

> "If an exchange would be within the provisions of subsection (b) * * (3) * * of this section (*otherwise than as a reorganization as defined in subsection (g)(1)(B) or subsection (g)(1)(C) of this section*) if it were not for the fact that the property received in

exchange consists not only of property permitted by such paragraph or by subsection (1) to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property."

SUMMARY OF ARGUMENT

The provisions of § 112(c)(1) of the 1939 Code literally and exactly fit the Turnbow exchange; hence the gain immediately recognized is limited to the net cash received. There is no dispute that the transaction as it stands is not a "reorganization" as defined; the case is that it would be such if it were not for the fact that cash was included. Turnbow's payment of the full tax on the cash, and postponement of recognition of gain as to the stock, are precisely consistent with the basic legislative pattern. There is no tax avoidance.

This literal application of § 112(c)(1) is the only reading of that statute consistent with the application of its counterpart § 112(e), and is further confirmed by the language of § 112(d).

With the language of the statute, as well as the legislative pattern, being as clear as it is, resort to committee reports or other legislative history is superfluous; but in any event the pertinent legislative history forcefully supports the taxpayer's literal reading of the statute. The Treasury regulations are also consistent.

The Commissioner and the court below err in contending that because a transaction as it stands does not fit within § 112(b)(3), it therefore does not fit within § 112 (c)(1). Section 112(c)(1) by its express terms applies to transactions which as they stand (because of the inclusion of money or other property) do not fit within § 112(b)(3) but would do so if the boot element were not present. That is the situation here.

ARGUMENT

FIRST: THE PROVISIONS OF § 112(c)(1) OF THE 1939 CODE LITERALLY AND PRECISELY FIT THE TURNBOW EXCHANGE. CONSEQUENTLY, THE GAIN IMMEDIATELY RECOGNIZED IS LIMITED TO THE NET CASH RECEIVED UPON THE EXCHANGE.

The Commissioner's entire case rests upon one misconception: that the problem somehow involves the question whether the transaction *as it stands* is a "reorganization" as defined in the code. Section 112(c)(1) plainly says exactly the opposite, as the language of the statute demonstrates.

Section 112(c)(1) declares that:

> "(c) GAIN FROM EXCHANGES NOT SOLELY IN KIND.—
>
> (1) If an exchange *would be* within the provisions of subsection (b) • • (3) • • of this section *if it were not for the fact that* the property received in exchange consists not only of property permitted by such paragraph • • to be received without the recognition of gain, but also of • • money, then the gain • • to the recipient shall be recognized, but in an amount not in excess of • • such money • •" (emphasis added).

The Turnbow transaction fits the statutory description in § 112(c)(1) with literal exactitude. In order to "be within the provisions of subsection (b)(3)" (Appx. infra, p. i), the transaction, in the present context, would have to be an exchange of stock or securities (a) "in a corporation a party to a reorganization," (b) "in pursuance of the plan of reorganization," (c) "solely for stock or securities • • in another corporation a party to a reorganization." Also in this context, "reorganization" means "the acquisition by one corporation, in exchange solely for all or part of its voting stock, of at least 80 per centum of the voting stock • • of another corporation" (§ 112(g)(1)(B); Appx. infra, p. iii).

In Turnbow, "if it were not for the fact that" the property received in exchange consisted not only of voting stock of Foremost but also of money, the transaction *would have been* an exchange of stock in one corporation "solely for stock • • in another corporation." Also, if cash had not been included, each of the two corporations *would have been* "a party to a reorganization" and the transaction would have been carried out in pursuance of a "plan of reorganization." The particular kind of reorganization would have been as defined in § 112(g)(1)(B), to wit, "the acquisition by one corporation [Foremost], in exchange solely for • • a part [82,375 shares] of its voting stock, of at least 80 per centum [in fact 100%] of the voting stock • • of another corporation [Supply]." Thereupon, under the reorganization plan, Supply was to become and continue operation as a wholly owned subsidiary of Foremost.[4]

---

[4]Other aspects of the reorganization—which even with the cash included was a true reorganization in the corporate sense—are summarized in the findings of fact (R. 33-34), and see, supra, this brief, page 4.

Section 112(b)(3) providing for *total* nonrecognition of gain postulates three things:

(1) exchange of stock or securities solely for stock or securities,

(2) in a corporation a party to a reorganization,

(3) in pursuance of a plan of reorganization.

There is no claim that the Turnbow exchange as it stands—i.e., with the cash included—meets these postulates for total nonrecognition of gain. But § 112(c)(1) does not refer to § 112(b)(3) in relation to the transaction *as it stands*. The reference is expressly hypothetical—"if it were not for the fact" that cash was included. So, hypothetically *excluding* cash, the transaction fits all three postulates, and § 112(c)(1) by its terms applies. There is no possible justification, expressed or hinted at in the statutory language, for splitting the reference so as to apply the hypothetical elimination of the cash element to *one* of the conditions *alone;* i.e., in determining whether the exchange is "solely for stock or securities," but not in determining whether it is "in pursuance of a plan of reorganization" as defined in § 112(g)(1).

The Court of Appeals for the Seventh Circuit in *Howard v. Commissioner of Internal Revenue* (7 Cir. 1956) 238 F.2d 943 readily recognized this logic. The question was the same as in the instant case. The court concluded (238 F.2d 948):

> "Thus we may conclude that, in determining when these so-called 'boot' provisions apply, Congress intended that the transaction is to be considered separate and apart from the 'boot' received in determining whether it meets the nonrecognition provisions.

> If the transaction, absent the 'other property or money', fulfills the requirements of § 112(b) (3), then gain is to be recognized to the extent that 'boot' is received.
>
> In the present case, *but for* the cash received in exchange for 19.81% of the common stock of Binkley, the transaction would have met the 'solely' requirement of § 112(g) (1) (B) and fallen within the scope of § 112(b) (3). To the extent that 'boot' was received, gain would be recognized under our interpretation of the application of § 112(c) (1)" (italics by the court).[5]

So we re-emphasize, this case nowhere involves the question whether the transaction *as it stands* is a "reorganization." Section 112(c)(1) expressly deals with situations which *as they stand* do *not* qualify under § 112(b) (3) because of the inclusion of boot, but would qualify if boot had not been included. That is the case at bar.

The fallacy in the contrary reasoning is self-evident. The argument is epitomized in the penultimate sentence of the opinion below (R. 64):

> "In the case before us, then, the existence of boot prevents § 112(g) (1) (B) from applying; since no reorganization exists, § 112(b) (3) cannot apply; § 112(c) is then also inapplicable."

---

[5]The same reasoning—i.e., "eliminate the cash and see what the transaction would then be"—was also the basis of a number of prior decisions under § 112(c)(1) and its predecessors: *Luther Bonham* (1936) 33 B.T.A. 1100, 1104; *Elizabeth Bruce* (1934) 30 B.T.A. 80, 82-83 (reversed on factual grounds (D.C.Cir. 1935) 76 F.2d 442); *R. C. Love* (1939) 39 B.T.A. 172, 180; *First Seattle D. H. Nat. Bank v. Commissioner of Int. Rev.* (9 Cir. 1935) 77 F.2d 45, 47, 48-49, as well as of the Tax Court in the case at bar (R. 38-39). Until the advent of the decision below, we know of no decision which did otherwise.

This is to say that, because the transaction does not fit the situation described in § 112(b)(3), therefore it does not fit the contrary situation described in § 112(c)(1). The non sequitur is manifest.

To find such a conclusion anywhere in the words of § 112(c)(1) would require rewriting the section. The words as written are the expressed intent of Congress (*United States v. Mo. Pac. R. Co.* (1929) 278 U.S. 269, 278).

SECOND: THE LITERAL APPLICATION OF THE WORDS OF § 112(c)(1) FITS THE BASIC LEGISLATIVE PATTERN, EFFECTING THE IMMEDIATE RECOGNITION AND TAXATION OF GAIN SO FAR AS THE CASH BOOT IS CONCERNED AND POSTPONEMENT OF TAXATION AS TO THE STOCK UNTIL SOME LATER TAXABLE DISPOSITION OF IT.

Section 112(c)(1) with its predecessor sections has stayed in the law substantially in its present form since 1923. During all that time the basic legislative pattern has been clear and unchanged:

> Section 112(a) and its predecessors establish the starting point; gains from sales and exchanges are immediately fully taxable *except*:—
>
> Gains from exchanges solely in kind (§ 112(b)) are tax free at the time (until profit is actually realized through some later taxable disposition of the property received); losses from such exchanges are likewise not recognized at the time;
>
> Gains from exchanges not solely in kind (§ 112(c)), where partly in kind and partly for money or other property (boot), are immediately taxable but not in excess of the value of the boot;
>
> Losses from exchanges not solely in kind (§ 112(e)) are not recognized.

When the taxpayer has merely exchanged one thing for another of the same kind, in all practical effect he has just what he had before, merely in different form. The basic policy of the income tax structure, then, is to postpone taxation of the property received in kind until it should become the subject of some later taxable transaction, and to limit any immediate tax to the amount of any money or property other than in kind which the taxpayer receives in the exchange. This is the policy which runs throughout §§ 112(a), (b), (c), (d) and (e).

The policy is thus summarized in a report of the subcommittee of the House Ways and Means Committee in connection with the Revenue Act of 1934 (Hearings before the Committee on Ways and Means, House of Representatives, 73d Congress, 2d Session, in connection with Revenue Revision 1934, pp. 59-60):

> "The underlying principle behind all of the exchange and reorganization provisions of the present law is that they do not result in tax exemption, but that the tax is postponed until a gain is realized from a pure sale or what amounts to a pure sale. The reasons assigned for such a policy are—
>
> (1) That such provisions prevent much of the uncertainty and litigation which was involved in the prior income-tax laws;
>
> (2) Normal business adjustments will not be interfered with if so-called 'paper profits' are exempted;
>
> (3) The revenues of the Government will be increased by preventing taxpayers from taking colorable losses."

The reorganization provisions are "tax-*deferring*, rather than tax-*exempting*, provisions" (Paul, Studies in Federal

Taxation, Third Series, 1940, p. 4). Transactions of this nature "are deemed by Congress to be transitional, continuing transactions which are not sufficiently 'closed' to justify *economically* • • the imposition of capital gains tax at the immediate moment." As to other types of income in the form of the equivalent of cash, there is an immediate imposition of tax; but "the legislative intent in the reorganization provisions is to permit nothing more than a postponement of tax incidence to some future time when there is more than a 'mere change in the form of ownership'" (id. pp. 4-5).

This policy fits the instant case. Turnbow has exchanged his voting stock of Supply for voting stock of Foremost, plus $3,000,000 in cash; Supply continues operation as a subsidiary of Foremost with a new executive structure. Turnbow has paid his tax on the cash component. As for the stock, he now holds voting stock of Foremost in lieu of voting stock of Supply in the course of reorganization of the latter. On the voting stock component of the transaction, Congress has postponed the imposition of the tax until the taxpayer sells or otherwise disposes of the stock in some way so as to convert any paper profit into an actual profit.

THIRD: THERE IS NO TAX AVOIDANCE. TURNBOW HAS PAID HIS FULL TAX ON THE CASH RECEIVED. WHEN HE MAKES ANY TAXABLE DISPOSITION OF THE FOREMOST STOCK, THE GAIN THEN REALIZED WILL BE SUBJECT TO TAX.

The propositions stated in the heading need no elaboration. Under § 112(c)(1), Turnbow was subject to immediate tax upon the cash part of the transaction, and has

paid his tax (R. 35). When he makes any taxable disposition of the Foremost stock, the gain then realized will be subject to tax. There is no tax avoidance.

FOURTH: THE LITERAL APPLICATION OF § 112(c)(1) AS ABOVE DEMONSTRATED IS THE ONLY APPLICATION OF THAT STATUTE CONSISTENT WITH THE APPLICATION OF § 112(e), ITS COUNTERPART WHERE LOSS HAS RESULTED, PRESCRIBING NONRECOGNITION OF SUCH LOSSES.

Section 112(e) of the Internal Revenue Code of 1939 covers the treatment of *losses*, in contrast to gains, from exchanges of property not solely in kind. Section 112(e), closely paralleling the language of § 112(c)(1), provides:

> "If an exchange would be within the provisions of subsection (b)(1) to (5), inclusive, * * of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized."

The parallel language of the two sections demands a like reading *(Davies Warehouse Co. v. Bowles* (1944) 321 U.S. 144, 150)—a proposition recognized in the *Howard* case, supra, and by the court below (R. 64). In *Howard*, the Court of Appeals for the Seventh Circuit reviewed the legislative history of § 112(e), particularly the report of the House Ways and Means Committee (H.Rept. 179, 68th Cong., 1st Sess., p. 15; C.B.1939-1, Pt. 2, pp. 241, 252) explaining the precursor of that statute (238 F.2d 948):

> *"Unless some provision is made for cases in which part of the consideration is money, the provisions of*

> *subdivision (b) could be avoided and the entire amount of the loss recognized if a small amount of money were received in addition to the specified property.* The only way to cover such a case and prevent the taxpayer from taking the entire loss by adding a small amount of money to the property received is to provide that no loss shall be recognized, otherwise the law might be evaded" (italics by the court).

If § 112(c)(1) did not apply to transactions qualifying as "B" or "C" reorganizations (i.e., reorganizations of the types defined in § 112(g)(1)(B) and (C)) except for the receipt of so-called "boot," correspondingly § 112(e) would not be applicable to such exchanges. In such event, it would be a simple matter to include in an otherwise obvious "reorganization" a nominal amount of boot, and thus forestall the application of § 112(e). "Paper losses" could readily be turned into tax deductible losses by this expedient. As the court in the *Howard* case pointed out (238 F.2d 948):

> "* * if respondent's argument is pursued to its ultimate conclusion, a taxpayer could have his entire loss recognized merely by taking slightly less stock in exchange for money or other property."

Hence the court in *Howard* concluded (238 F.2d 948) that Congress intended the transaction to be considered separate and apart from the "boot" received in determining whether it met the nonrecognition provisions—thus confirming its like conclusion as to the interpretation of § 112(c)(1). In the instant case the court below expressly referred to this determination in the *Howard* case (R. 62) and refused to follow it. Instead the court below assumed,

without justification, that Congress accepted the potentialities of tax evasion (converting paper losses into tax losses by injecting a trifling amount of cash) which attend the Commissioner's argument (R. 63).[6]

FIFTH: SECTION 112(d) REAFFIRMS THE TAXPAYER'S READING OF SECTION 112(c).

Section 112(d) of the 1939 Code provides:

> "If an exchange would be within the provisions of subsection (b) (4) or (10) of this section if it were not for the fact that the property received in exchange consists not only of stock or securities permit-

[6]In support of its assumption, the court below quoted out of context (R. 63) a sentence from the House Ways and Means Committee Report (H.Rept. 704, 73d Cong., 2d Sess., 14), from which, said the court, it would appear that Congress relied upon the other definitions in § 112(g)(1) to avoid the danger of tax avoidance. The full context of the report makes it clear that the "other reorganization provisions" to which the committee referred were not the remaining definitions in § 112(g)(1), but were the other reorganization provisions in § 112, primarily the various provisions of § 112(b) and (e).

In a footnote (R. 63) the court below also referred to a report of a subcommittee of the House Ways and Means Committee recommending elimination of all the exchange and reorganization provisions. The full committee rejected the suggestion. "The committee decided that, under present conditions, the wiser policy is to amend the provisions drastically to stop the known cases of tax avoidance, rather than to eliminate the sections completely" (H.Rept. 704, 73d Cong., 2d Sess., 13; C.B. 1939-1, Pt. 2, 564). Far from expressing an intention to accept tax avoidance as a necessary evil, the full committee proceeded on the intention to stop cases of tax avoidance.

This misuse of legislative history by the court below is further compounded by its disregard of the committee report expressly dealing with the predecessor of § 112(e) (§ 203(f) of the Revenue Act of 1924) which made plain the intention of Congress to prevent, rather than to accept, loss taking. This report is more fully discussed and quoted from in the review of legislative history infra this brief, pages 21-22.

ted by such paragraph to be received without recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed."[7]

Here again Congress has decreed limited recognition of gain in a transaction which, *as it stands*, would not be a reorganization because of the inclusion of other property or money, but which hypothetically *would be* a reorganization if the boot were disregarded. Again the language is clear and explicit; there is no hint of hidden exceptions. Moreover, in this section Congress twice speaks of "the plan of reorganization" in the same breath with the receipt of "other property or money." If the Commissioner's contention were correct, the inclusion of the boot would defeat the full application of the section because subsection (b)(4), like subsection (b)(3), postulates "a party to a reorganization * * in pursuance of the plan of reorganization"; yet within the express terms of § 112(d) Congress speaks generally of "the plan of reorganiza-

[7]These provisions first appeared in the Revenue Act of 1924 as § 203(e), concurrently with § 203(f) which became § 112(e) of the 1939 Code.

tion" in connection with exchanges which include "other property or money."

SIXTH: THE COMMISSIONER'S CONTENTION CANNOT BE JUSTIFIED BY ANYTHING IN THE LEGISLATIVE HISTORY OF § 112(c)(1) OR OF ITS RELATED STATUTES. ON THE CONTRARY, THE LEGISLATIVE HISTORY CONFIRMS THE EXPRESS WORDS OF THE STATUTE.

Where the language of the statute is clear and unambiguous, as it is here, excursions into legislative history and other extraneous materials are not only superfluous but improper,

Gemsco, Inc. v. Walling (1945) 324 U.S. 244, 260;
Helvering v. City Bank Co. (1935) 296 U.S. 85, 89;
United States v. Mo. Pac. R. Co. (1929) 278 U.S. 269, 278;
Van Camp & Sons v. Am. Can Co. (1929) 278 U.S. 245, 253-254,

—a rule "which applies with peculiar strictness" to taxing statutes,

Crooks v. Harrelson (1930) 282 U.S. 55, 61.

However, when the legislative history of § 112(c)(1) and related statutes is examined, it is seen to confirm the intent of Congress as embodied in the express words of the statute,[8] despite efforts of the Commissioner and of the court below to find indications to the contrary.

Sections 112(c)(1) and (e) have been in all successive revenue acts since the Revenue Act of 1924 without sub-

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[8]Legislative history "may be noticed in *confirmation* of the meaning conveyed by the words used" (*United States v. Mo. Pac. R. Co.*, supra, 278 U.S. 269, 278 (emphasis added).

stantial change. The counterpart of § 112(c)(1) was originally enacted as § 202(e) of the Act of March 4, 1923, 42 Stat. 1560. Prior to that time taxpayers were permitted to offset the value of any boot received in an otherwise tax-free exchange against their investment in the property exchanged before boot became taxable. This treatment was objectionable as it permitted the receipt of cash frequently without tax in the case of exchanges not solely in kind (H.Rept. 1432, 67th Cong., 4th Sess., 3 (C.B. 1939-1, Pt. 2, 845)). This report goes on to state:

> "The bill provides that the amount of gain resulting from such exchange shall be computed in accordance with the ordinary method, which is that the gain is computed by subtracting from the total value of all the property received in exchange the cost of the property given in exchange, but with a provision that the taxable gain shall not exceed the amount of the 'boot' received in exchange. Thus, if a taxpayer exchanges stock which cost him $100 for stock in a new corporation, together with $100 in 'boot,' the stock of the new corporation received in exchange would be valued, and if it is found that it is worth $100 the total amount received by the taxpayer has been $200, which is $100 in excess of the cost of the old, and he would therefore, under the proposed law, pay a tax on a gain of $100. If, however, the amount of the 'boot' received is only $95 and the stock in the new corporation is worth $105, he has made the same gain of $100, but he would be taxed only on $95, namely, the amount of the 'boot' received in exchange. *The reason for this is that the profit, so far as it is contained in the new stock received, has not yet been realized, and therefore should not be taxed until the new stock is sold or in some way disposed of so that the profit will be actually realized*" (emphasis added).

This report was approved by the Senate without change (S.Rept. 1113, 67th Cong., 4th Sess., 1-3 (C.B. 1939-1, Pt. 2, 845)). It clearly demonstrates the manner in which the "boot" provision was to operate, and there has been no change in the substance of that provision since that time.

The Revenue Act of 1924 for the first time included § 203(f) (the predecessor of § 112(e) of the 1939 Code). The Ways and Means Committee report on this subsection stated (H.Rept. 179, 68th Cong., 1st Sess., 15 (C.B. 1939-1, Pt. 2, 252)):

> "Section 203(f): There is no provision in the existing law which corresponds to subdivision (f), and there is no ruling by the Treasury Department on a case such as is covered by this subdivision. This subdivision provides that in the case in which 'boot' is received in connection with a transaction from which there would otherwise be no deductible loss, no loss is to be recognized. In case the exchange results in a gain, the situation is covered in subdivision (d)(1) by a provision that the gain shall be recognized in an amount not in excess of the 'boot.' This limitation, however, is not a logical one, if applied to the case of an exchange resulting in a loss. Subdivision (b) of this section provides that no loss shall be recognized if the entire consideration for the exchange is a certain type of property. Unless some provision is made for cases in which part of the consideration is money, the provisions of subdivision (b) could be avoided and the entire amount of the loss recognized if a small amount of money were received in addition to the specified property. The only way to cover such a case and prevent the taxpayer from taking the entire loss by adding a small amount of money to the

property received is to provide that no loss shall be recognized, otherwise the law might be evaded."[9]

The legislative history of these complementary provisions demonstrates that Congress did not intend either that the scope of the requirements of § 112(b) for tax-free exchanges could be avoided by the simple expedient of injecting a nominal amount of boot into the exchange, or that gains from exchanges not solely in kind should be recognized in their entirety.

The committee reports accompanying the statutory revisions in 1934—the changes on which the Commissioner bottoms his argument—carry forward the same treatment of limited recognition of gain in "boot" situations, and particularly demonstrate that Congress specifically intended to apply exactly the same treatment to "B" and "C" type reorganizations as to other types.

Congress was concerned, as clearly disclosed by the full context of the committee reports, with the tax-free receipt of stocks and securities by stockholders who had substantially changed their interest, and more particularly, with the prevention of loss-taking when the shareholders had not changed the nature of their interest.

Section 112(c)(1) is not even mentioned in any of the committee reports on the Revenue Act of 1934, and the content of the reports as a whole shows that the revision of § 112(g) was in no way concerned with the transaction in the present case.

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[9]The contemporaneous Senate report (S.Rept. 398, 68th Cong., 1st Sess., Pt. 2, 16 (C.B. 1939-1, 277)) is practically identical in wording.

The Senate Finance Committee report on the 1934 Act explained the new definition of a reorganization exchange, adding reference to the acquisition by one corporation solely for its voting stock of at least 80 per cent of the voting stock and all other classes of stock of another corporation, or substantially all the properties of such other corporation. This report stated (S.Rept. 558, 73d Cong., 2d Sess., 16-17 (C.B. 1939-1, Pt. 2, pp. 598-599)):

> "Your committee is in complete agreement with the purposes of the House bill which aim at tax avoidance schemes in this connection. However, some modifications are recommended in order to bring about a more uniform application of the provisions in all 48 of the States. Not all of the States have adopted statutes providing for mergers or consolidations; and, moreover, a corporation of one State can not ordinarily merge with a corporation of another State. The committee believes that it is desirable to permit reorganizations in such cases, with restrictions designed to prevent tax avoidance. * *
>
> * * * * *
>
> The committee believes that these transactions, when carried out as prescribed in this amendment are in themselves sufficiently similar to mergers and consolidations as to be entitled to similar treatment. It will be noted that the proposed amendment requires that (1) the acquiring corporation must obtain at least 80 percent of the * * stock of the other corporation, * * and (2) the acquisition, whether of stock or of substantially all the properties, must be in exchange solely for the voting stock of the acquiring corporation."

Specifically the Senate Finance Committee believed that transactions of this type were sufficiently similar to mer-

gers to be entitled to similar tax treatment. This similarity could scarcely exist if the injection of a nominal amount of cash in the one case (mergers) would result in limited recognition of gain, while injection of a nominal amount of cash in the other case ("B" and "C" type reorganizations) would result in recognition of the entire gain. Such equality of treatment is natural and reasonable. It is not uncommon—rather it is usual—that stockholders of component corporations in mergers and consolidations receive a substantial amount of cash, as well as innumerable combinations of stock and securities, in exchange for their previous interests. The distribution of boot in a merger is frequently employed as a device which equalizes values of the merged corporations (cf. *Isabella M. Sheldon* (1946) 6 T.C. 510). Congress well knew this.

Moreover, both the Senate and the House reports with respect to the 1934 Act demonstrate an overriding concern with the necessity of preventing stockholders from incurring large tax losses under circumstances where their interests remain substantially unchanged before and after the exchange. In view of the financial condition of the economy at that time, this concern is entirely understandable. If subsections "B" and "C" had not been included in the definition of a reorganization under § 112(g), § 112 (e) would not have prevented the taking of substantial paper losses, because § 112(e) disallows losses only in transactions which but for the boot would have come within 112(b)(3) and 112(g). Certainly, then, Congress could not possibly have intended to permit loss-taking by the simple expedient of injecting a nominal amount of cash or other property into the exchange, which would

have been the result if in "B" and "C" type reorganizations such cash or other property were also distributed. The above Senate Finance Committee Report No. 558, 73d Congress, 2d Session, 17 (C.B. 1939-1, Pt. 2, 599) went on to state:

> "Your committee approves the retention of the exchange and reorganization provisions with these changes [reinstatement of B and C type reorganizations]. Reorganizations are now being consummated in the majority of cases to reduce the capital structure, and to strengthen the financial condition of the participating corporations. If the reorganization provisions were omitted from the bill, many stockholders and bond-holders could take large losses, although they might retain substantially their former interests in the enterprise. Hence, the Treasury has little or nothing to gain by the elimination of these provisions, while, on the other hand, some legitimate and desirable business readjustments would be prevented."

These, then, were the objects that Congress had in mind—to equalize tax treatment of statutory mergers and consolidations and transactions which, though similar in substance, technically would not meet local statutory requirements for mergers and consolidations; and to prevent the taking of paper losses in boot situations—*not* to make special and contradictory exceptions in the application of § 112(c)(1).

Finally, in 1939, in connection with the so-called "Hendler amendment,"[10] the committee reports stated unequiv-

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[10]In *United States v. Hendler* (1938) 303 U.S. 564, this court had held that the assumption of liabilities in a statutory merger

ocally the broad intent of the statute to postpone the recognition of gain in corporate acquisitions, except where "other property or money" was received and then to recognize the gain only to the extent of the latter. As the House Committee stated (H.Rept. 855, 76th Cong., 1st Sess., 18 (C.B. 1939-2, p. 518)):

> "It has long been the policy in our income tax law to give due consideration to the exigencies of business in connection with corporate reorganizations by postponing, in certain specifically described instances, the recognition of gain realized in such transactions. In general, if gain is realized in such a transaction, ***non-recognition of the entire gain*** is allowed only where, under the specifically defined circumstances, the taxpayer transfers property and receives in exchange therefor stock or securities in a corporation which is a party to the reorganization. If, in addition to such stock or securities, other property or money is received, ***gain is recognized to the extent of such other property or money***" (emphasis added).

These are plain expressions of the intent of Congress. They confirm the literal language of the statute.

The references above given are to the Congressional Committee reports dealing with the provisions involved in this case—§ 112(c)(1) and, by correlation, § 112(e). By contrast, the references cited by the court below are to another question entirely—the laws dealing with *total* non-

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constituted taxable boot to the merged corporation under §§ 112 (b)(4) and (d)(2).

By the "Hendler amendment" Congress sought to prevent the assumption of liabilities from being considered boot and at the same time prevent such assumption from disqualifying the transaction under § 112(g)(1)(C); also to insure that the tax basis carryover provisions applicable to tax-free exchanges should apply to such transactions.

recognition of gains from exchanges solely in kind. There is no dispute about them; they simply do not apply.

For example, the court below first cites (R. 58-59) a committee report dealing with § 112(g)(1) and relating to reorganizations *without income tax liability*. Admittedly, the Turnbow transaction, with the cash included, was not such a reorganization without income tax liability—Turnbow was liable for and paid the tax on the cash—but *it would have been a reorganization without income tax liability if it were not for the fact that cash was included*, and we have a § 112(c)(1) situation precisely.

Next, the court below cites (R. 59) a letter from the Secretary of the Treasury, which mentions the desirability of permitting business readjustments *without tax consequences* where no cash is received. The same observations apply; the reference is not to the § 112(c) situation but to the total nonrecognition situation.

Third, the court below cites (R. 59-60) a subcommittee's suggestion which was *not* adopted, and then a House committee's suggestion which was *not* adopted—certainly no expressions of the intent of the contrary provisions which Congress did adopt.

Fourth, the court below cites (R. 60) the Senate Committee report dealing with § 112(g)(1)(B) as finally adopted. This report, however, (1) makes the point of similarity with mergers and consolidations (supra, p. 23) which strongly indicates the intent to provide parallel tax treatment for A-, B-, C- and D-type reorganizations rather than to exclude B and C reorganizations from such treatment as the court below theorized, and (2) refers to restrictions designed to prevent tax avoidance by lim-

iting the *total* nonrecognition situations but not otherwise relating to the § 112(c)(1) situation.

The next bit of legislative history (R. 61-62) cited by the court below was the "Hendler amendment" (supra, p. 25) providing that in a C-type reorganization the assumption of liabilities by the acquiring corporation should be disregarded in determining whether an exchange was solely for voting stock. While the court below suggests (R. 62) that under our construction of § 112(c)(1) this amendment was unnecessary, that conclusion is wholly in error. The stock of the acquiring corporation would ordinarily pass through to the shareholders of the acquired corporation, but nothing passes to them in respect of the assumed liabilities. Hence, under the doctrine of the *Hendler* case (*United States v. Hendler* (1938) 303 U.S. 564) the entire gain would be taxable to the shareholders because (1) the transaction would not attain total nonrecognition under § 112(b)(3) because not within the definition of a reorganization, and (2) it would not attain limited nonrecognition under § 112(c)(1) because the shareholders *received* no money or other property in addition to the stock. The Hendler amendment accorded total nonrecognition to this situation. It was necessary without any regard to § 112(c).

Also contrary to the court below, the committee reports accompanying the Hendler amendment, as noted above, unequivocally demonstrate the applicability of the § 112(c)(1) principle to the situation where money is added to an exchange of stock in a corporation which is a party to a corporate reorganization (supra, p. 26), and certainly indicate nothing to the contrary.

The court below next cites (R. 62) the 1954 Code amendment (§ 368(a)(2)(B)), amending the definition of a C-type reorganization (exchange by a corporation of its voting stock for substantially all the assets of another corporation) to permit the transaction to include boot as payment for up to 20% of the assets of the acquired corporation and still qualify as a reorganization—an amendment which the court said would also be unnecessary if our reading of § 112(c)(1)[11] is correct. The amendment was, however, necessary on totally different grounds. The 1954 Code also newly included the terms of § 381, a relief measure permitting and requiring the successor corporation in a C-type reorganization to carry over the tax attributes of the transferor corporation (Appx. infra, p. vi). These important effects, such as net operating loss carryover, accounting methods, earnings and profits carryover—for all practical purposes the entire tax history of the transferor—hinge directly upon qualifying within the definition of a C-type reorganization.

In summary, the legislative history establishes:

First, Congress intended as a broad policy to postpone tax effects as to like-for-like exchanges in a wide variety of transactions, considering it appropriate to delay the incidence of taxation until some profit or loss should actually be realized. At the same time, Congress provided for immediate taxation of "boot" additions to like-for-like exchanges.

Second, in adopting the 1934 changes, including all the definition provisions upon which the Commissioner now

[11]Which, in the 1954 Code, has become § 356(a)(1). (Appx. infra, p. iv.)

relies, Congress expressly intended to provide similar tax treatment as between mergers and consolidations, on the one hand, and B-, C- and D-type reorganizations on the other, while doing nothing to touch the limited-recognition provisions relating to "boot" transactions.

Third, nothing cited from the legislative history by the Commissioner or the court below supports the Commissioner's contentions. At the most, their citations reflect the intent of Congress to eliminate certain tax avoidance schemes whereby a stockholder could fabricate a fictitious corporate reorganization and escape all immediate taxation. All references thus cited expressly refer to *tax-free* transactions, never to "boot" transactions immediately taxable to the extent of the boot.

Fourth, most significantly, nothing in the so-called legislative history, dealing with the 1934 or later amendments, makes any reference whatever to the long-standing provisions for iimited recognition of gain in "boot" transactions. The court below assumes that Congress, after the 1934 amendments, intended the hypothesis expressed in §§ 112(c)(1) and (e)—i.e., if it were not for the inclusion of boot—to apply to A- and D-type reorganizations but not to B- and C-type reorganizations. It strains credulity, we respectfully submit, to suppose such an intent on the part of Congress so to reconstruct these provisions without any change in their wording and without a single reference to such supposed effect in any of the reports explaining the legislative changes.

Fifth, the legislative history of the corollary nonrecognition-of-loss provisions (§ 112(e)) conclusively demonstrates the Congressional intent *not* to permit loss taking

through the device of injecting a nominal amount of cash into what would otherwise have been a reorganization in which no gain or loss would be immediately recognized. The contrary assumption of the court below has no valid support.

SEVENTH: THE TREASURY REGULATIONS ARE CONSISTENT WITH AND CORROBORATE THE TAXPAYER'S POSITION.

The Treasury regulations under § 112(c) (Appx. infra, p. viii) merely show by example how the statute operates, providing for nonrecognition of gain in boot transactions except to the extent of the boot. Over many years, extending both before and after the 1934 amendments, the regulations have remained substantially unchanged. The return filed by Turnbow is in harmony with them and with the example showing the operation of § 112(c).

If the 1934 amendment of § 112(g)(1)(B), on which the Commissioner bases his contention, had indeed changed the rule of the "but-for" application of § 112(c), it was obviously incumbent upon the Commissioner to point out the change by an appropriate amendment of the regulations pertaining to the latter section. This he did not do.

An illuminating sidelight in the history of the regulations appears in the series of regulations relating to § 112(g)(1). In connection with the 1934 Act, the Commissioner first issued a regulation (Regs. 86, Art. 112(g)-2) which provided:

> "If, for example, Corporation X exchanges nonvoting preferred stock or bonds in addition to all or a part of its voting stock in the acquisition of the required

> amount of stock, or of the properties, of Corporation Y, the transaction is not a 'reorganization' exchange, *and the gain or loss therefrom will be recognized*" (emphasis added).

From this it would appear that the Commissioner at first considered that the 1934 Act required the recognition of the entire amount of gain or loss on boot transactions that would presumably have qualified as B-type reorganizations *but for* the boot.

By the time of the issuance of Regulations 101 in connection with the Revenue Act of 1938, the Commissioner realized the inconsistency and revised the regulation to read as follows (Regs. 101, Art. 112(g)-2; repeated in Regs. 118, § 39.112(g)-2 in connection with the 1939 Code):

> "If, for example, Corporation X exchanges nonvoting preferred stock or bonds in addition to all or a part of its voting stock in the acquisition of the required amount of stock of Corporation Y, the transaction is not a 'reorganization' under section 112(g)(1)(B)."

Both the rationale and the effect of this change are obvious. To permit the recognition of loss in boot transactions of this type would fly directly contrary to the specific nonrecognition-of-loss provisions of § 112(e) as well as contrary to the expressed Congressional intent shown hereinabove. Obviously, too, if it was improper under § 112(e) to recognize loss in the example stated in the regulation, it would be equally improper to recognize the *entire* gain inasmuch as § 112(c) limited the recognition of gain to an amount not in excess of the value of the boot received. In sum, the example given in the regulations,

though not constituting a reorganization under § 112(g)-(1)(B) *as it stands*, would nevertheless be subject to the nonrecognition-of-loss provisions of § 112(e) and the limited-recognition-of-gain provisions of § 112(c); and that is what the revised regulation obviously intended to recognize.

The single reference which the court below has marshaled in support of its conclusion (R. 64) is an excerpt from § 39.112(g)-1(c) of Regulations 118:

> "'From its context the term "a party to a reorganization" can only mean a party to a transaction specifically defined as a reorganization by section 112(g). * * The provisions of the Internal Revenue Code referred to in this paragraph [this includes § 112(c)] are inapplicable unless there is a plan of reorganization. A plan of reorganization must contemplate the bona fide execution of one of the transactions specifically described as a reorganization in section 112(g) and for the bona fide consummation of each of the requisite acts under which nonrecognition of gain is claimed'" (R. 64—the bracketed interpolation is by the court).

It is plain that the particular reference above to the provisions of the Internal Revenue Code does not have the broad scope attributed to it by the court below. If it did extend to include § 112(c)—even though that section was elsewhere mentioned in that paragraph of the regulations—then the sentence would mean that § 112(c) is inapplicable unless there is a plan of reorganization. This is patently untrue. Apart from the transaction in the case at bar, this reading would exclude such exchanges as a hotel for a hotel-plus-cash, for example, or a farm for a

farm-plus-cash, or innumerable exchanges of like for like-plus-boot which are the very essence of the application of § 112(c). If the sentence of the regulation referred to means anything at all, it must refer only to the various provisions of § 112(g) and the transactions specifically defined in that section.

EIGHTH: THE ERROR OF THE COURT BELOW LIES IN A LOGICAL FALLACY COMBINED WITH A FUNDAMENTAL MISCONCEPTION OF THE ISSUE. THE ISSUE IS NOT WHETHER THE TURNBOW EXCHANGE AS IT STANDS CONSTITUTES A REORGANIZATION—CLEARLY IT DOES NOT—BUT WHETHER § 112(c) APPLIES WHERE THE EXCHANGE WOULD FALL WITHIN THE REORGANIZATION DEFINITION IF IT WERE NOT FOR THE INCLUSION OF CASH.

As the court below epitomized its position (R. 64), the existence of boot prevents the Turnbow exchange from falling within the definition of a reorganization; therefore the transaction does not fit within § 112(b)(3) so as to be wholly *non*taxable; therefore it does not fit within § 112(c)(1) so as to be immediately taxable to the extent of the boot. The fallacy is manifest; there is an utter absence of logical sequitur between the second and final steps. The plain language of § 112(c)(1) deals, not with what *does* fit within § 112(b)(3), but with that which does *not* fit within § 112(b)(3) but which would do so if there were no boot involved. And that is this case.

Again and again the opinion of the court below expands this logical fallacy into a fundamental misconception of the issue in this case. The essence of the court's opinion is to establish that an exchange of stock for stock-plus-

cash cannot be a "reorganization" within the definition of § 112(g)(1)(B). Thus the court said (R. 64):

> "We conclude that, if the 'solely for voting stock' requirement of (B) and (C) reorganizations is to be given the effect intended by Congress, § 112(c) cannot operate to render a stock-plus-boot acquisition a (B) or (C) reorganization through a disregard of the existence of boot."

There is no dispute in this case, and never has been, that the Turnbow exchange as it stands does not fit within the § 112(g)(1)(B) definition of reorganization. When the court below says, as it has done repeatedly throughout its opinion, that this is the issue in the case, it is presupposing a dispute that is nonexistent.

The basic issue, in reality, is whether § 112(c)(1) applies to exchanges which, as they stand, are not reorganizations. The answer is that it does. Its essence is that in a like-for-like-plus-boot exchange, the tax effect as to the like-for-like is postponed while the tax effect as to the boot is immediate. This philosophy applies equally well to a voting-stock-for-voting-stock-plus-cash exchange (when the like-for-like element is sufficiently met by the 80 per cent limitation), as to a hotel-for-hotel-plus-cash exchange or a farm-for-farm-plus-cash.

In this there is no quarrel with *Helvering v. Southwest Corp.* (1942) 315 U.S. 194. There this court said that "solely for voting stock" in § 112(g)(1) means what it says. We agree. *Southwest* dealt with a question of tax basis for gain or loss which turned precisely upon whether the transaction was within the definition of reorganization or not. It did not deal with a "would-be-a-reorganization-

but-for" question, and none of the language in the opinion bears upon that question.

There is, therefore, no justification for the suggestion of the court below that to apply § 112(c) according to its literal terms would "frustrate at birth" (R. 61) Congress' intention to tighten the definition of B and C reorganizations when it restricted them to exchanges "solely" for voting stock. Without the amendment, a taxpayer could exchange voting stock for stock and debentures, for example (and thereby change his interest from equity owner to creditor), *tax-free* under § 112(b)(3). Congress decided to change this rule, and did so. Debentures or other securities were no longer tax-free consideration in an exchange for voting stock. To the extent that the consideration might include debentures *in addition* to voting stock, the debentures would be immediately taxable as boot under § 112(c), preserving the literal application and the policy of that statute. Again this is fully in accord with the provisions determining the tax effect where a reorganization as such is concerned, and also fully in accord with the provisions determining the tax effect where a "would-be-a-reorganization-but-for" transaction is concerned.

In net result, the tax pattern is plain, and the words of § 112(c)(1) are plain. They admit no unexpressed exceptions.

CONCLUSION

We respectfully submit that the judgment of the court below is erroneous and should be reversed.

Dated: August 25, 1961.

Respectfully submitted,

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(Appendix Follows.)

Appendix

Internal Revenue Code of 1939:

"SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) GENERAL RULE.—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) EXCHANGES SOLELY IN KIND.—

* * * * *

(3) STOCK FOR STOCK ON REORGANIZATION.—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization."

53 Stat. 37.

"(c) GAIN FROM EXCHANGES NOT SOLELY IN KIND.—

(1) If an exchange would be within the provisions of subsection (b) (1), (2), (3), or (5), or within the provisions of subsection (l), of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph or by subsection (l) to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property."

53 Stat. 39, as amended by Revenue Act of 1943, c. 63, sec. 121(d)(1), 58 Stat. 43.

"(d) SAME—GAIN OF CORPORATION.—If an exchange would be within the provisions of subsection (b) (4) or (10) of this section if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed."

53 Stat. 39, as amended by Revenue Act of 1943, c. 63, sec. 121(d)(2), 58 Stat. 43.

"(e) LOSS FROM EXCHANGES NOT SOLELY IN KIND.—If an exchange would be within the provisions of subsection (b) (1) to (5), inclusive, or (10), or within the provisions of subsection (l), of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized."

53 Stat. 39, as amended by Revenue Act of 1943, c. 63, sec. 121(d)(3), 58 Stat. 43.

"(g) DEFINITION OF REORGANIZATION.—As used in this section (other than subsection (b) (10) and subsection (l)) and in section 113 (other than subsection (a) (22))—.

(1) The term 'reorganization' means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation, or (C) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of substantially all the properties of another corporation, but in determining whether the exchange is solely for voting stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded, or (D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its shareholders or both are in control of the corporation to which the assets are transferred, or (E) a recapitalization, or (F) a mere change in identity, form, or place of organization, however effected.

(2) The term 'a party to a reorganization' includes a corporation resulting from a reorganization and includes both corporations in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another."

53 Stat. 40, as amended by Revenue Act of 1939, c. 247, sec. 213(b), 53 Stat. 870, and Revenue Act of 1943, c. 63, sec. 121(d)(4), 58 Stat. 43.

Internal Revenue Code of 1954:

"SEC. 356. RECEIPT OF ADDITIONAL CONSIDERATION.

(a) GAIN ON EXCHANGES.—

(1) RECOGNITION OF GAIN.—If—

(A) section 354 or 355 would apply to an exchange but for the fact that

(B) the property received in the exchange consists not only of property permitted by section 354 or 355 to be received without the recognition of gain but also of other property or money,

then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

• • • • •

(c) Loss.—If—

(1) section 354 would apply to an exchange, or section 355 would apply to an exchange or distribution, but for the fact that

(2) the property received in the exchange or distribution consists not only of property permitted by section 354 or 355 to be received without the recognition of gain or loss, but also of other property or money,

then no loss from the exchange or distribution shall be recognized."

68A Stat. 115.

"SEC. 368. DEFINITIONS RELATING TO CORPORATE REORGANIZATIONS.

(a) REORGANIZATION.—

(1) IN GENERAL.—For purposes of parts I and II and this part, the term 'reorganization' means—

* * * * *

(C) the acquisition by one corporation, in exchange solely for all or a part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), of substantially all of the properties of another corporation, but in determining whether the exchange is solely for stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded;

* * * * *

(2) SPECIAL RULES RELATING TO PARAGRAPH (1).—

* * * * *

(B) ADDITIONAL CONSIDERATION IN CERTAIN PARAGRAPH (1) (C) CASES.—If—

(i) one corporation acquires substantially all of the properties of another corporation,

(ii) the acquisition would qualify under paragraph (1) (C) but for the fact that the acquiring corporation exchanges money or other property in addition to voting stock, and

(iii) the acquiring corporation acquires, solely for voting stock described in paragraph (1) (C), property of the other corporation having a fair market value which is at least 80 percent of the fair market value of all of the property of the other corporation,

then such acquisition shall (subject to subparagraph (A) of this paragraph) be treated as qualifying under paragraph (1) (C). Solely for the purpose of determining whether clause (iii) of the preceding sentence applies, the amount of any liability assumed by the acquiring corporation, and the amount of any liability to which any property acquired by the acquiring corporation is subject, shall be treated as money paid for the property."

68A Stat. 120-121.

"SEC. 381. CARRYOVERS IN CERTAIN CORPORATE ACQUISITIONS.

(a) GENERAL RULE.—In the case of the acquisition of assets of a corporation by another corporation—

• • • • •

(2) in a transfer to which section 361 (relating to nonrecognition of gain or loss to corporations) applies, but only if the transfer is in connection with a reorganization described in subparagraph (A), (C), (D) (but only if the requirements of subparagraphs (A) and (B) of section 354 (b) (1) are met), or (F) of section 368 (a) (1).

the acquiring corporation shall succeed to and take into account, as of the close of the day of distribution or transfer, the items described in subsection (c) of the distributor or transferor corporation, subject to the conditions and limitations specified in subsections (b) and (c).

• • • • •

(c) ITEMS OF THE DISTRIBUTOR OR TRANSFEROR CORPORATION.—The items referred to in subsection (a) are:

(1) NET OPERATING LOSS CARRYOVERS. * * *

(2) EARNINGS AND PROFITS. * * *

(3) CAPITAL LOSS CARRYOVER. * * *

(4) METHOD OF ACCOUNTING. * * *

(5) INVENTORIES. * * *

(6) METHOD OF COMPUTING DEPRECIATION ALLOWANCE. * * *

(8) INSTALLMENT METHOD. * * *

(9) AMORTIZATION OF BOND DISCOUNT OR PREMIUM. * * *

(10) TREATMENT OF CERTAIN EXPENSES DEFERRED BY THE ELECTION OF DISTRIBUTOR OR TRANSFEROR CORPORATION. * * *

(11) CONTRIBUTIONS TO PENSION PLANS, EMPLOYEES' ANNUITY PLANS, AND STOCK BONUS AND PROFIT-SHARING PLANS. * * *

(12) RECOVERY OF BAD DEBTS, PRIOR TAXES, OR DELINQUENCY AMOUNTS. * * *

(13) INVOLUNTARY CONVERSIONS UNDER SECTION 1033. * * *

(14) DIVIDEND CARRYOVER TO PERSONAL HOLDING COMPANY. * * *

(15) INDEBTEDNESS OF CERTAIN PERSONAL HOLDING COMPANIES. * * *

(16) CERTAIN OBLIGATIONS OF DISTRIBUTOR OR TRANSFEROR CORPORATION. * * *

(17) DEFICIENCY DIVIDEND OF PERSONAL HOLDING COMPANY. * * *

(18) PERCENTAGE DEPLETION ON EXTRACTION OF ORES OR MINERALS FROM THE WASTE OR RESIDUE OF PRIOR MINING. * * *

(19) CHARITABLE CONTRIBUTIONS IN EXCESS OF PRIOR YEARS' LIMITATION. • • •

(20) CARRY-OVER OF UNUSED PENSION TRUST DEDUCTIONS IN CERTAIN CASES. • • •

(21) PRE-1954 ADJUSTMENTS RESULTING FROM CHANGE IN METHOD OF ACCOUNTING. • • •

(22) SUCCESSOR LIFE INSURANCE COMPANY. • • •"

68A Stat. 124-129, as amended by Public Law 74, 84th Congress, 1st Session, c. 143, sec. 2(1), 69 Stat. 134; by Public Law 396, 84th Congress, 2d Session, c. 15, 70 Stat. 7; by Public Law 85-866, 85th Congress, 2d Session, sec. 29(c), 72 Stat. 1628; and by Public Law 86-69, 86th Congress, 1st Session, sec. 3(c)(1), 73 Stat. 139.

Treasury Regulations 118, promulgated under the Internal Revenue Code of 1939:

"§ 39.112 (a)-1 *Sales or exchanges.*

• • • • •

(c) The Internal Revenue Code makes specific provision for the case in which, in addition to property which may be received tax free on the exchange, there is received as boot other property or money. In such a case gain is recognized to the extent of the boot (see section 112 (c) and (d)), but no loss of any kind is recognized (see section 112 (e))."

Code of Federal Regulations, Revised 1953, page 596.

"§ 39.112 (c)-1 *Receipt of other property or money in tax-free exchange not connected with corporate reorganization.* (a) If in any transaction in which prop-

erty held for investment or productive use in trade or business is exchanged for property of like kind to be held either for productive use or for investment: or if common stock is exchanged for common stock, or preferred stock for preferred stock, in the same corporation and not in connection with a corporate reorganization; or if property is transferred by one or more persons to a corporation for its stock or securities, within the meaning of section 112 (b) (5), there is received by the taxpayer other property (in addition to property permitted to be received without recognition of gain) or money, then

(1) The gain, if any, to the taxpayer will be recognized in an amount not in excess of the sum of the money and the fair market value of the other property, but

(2) The loss, if any, to the taxpayer from such an exchange is not to be recognized to any extent (see section 112 (e)).

(b) The application of this section may be illustrated by the following example:

Example. A, who is not a dealer in real estate, in 1952 exchanges real estate, which he purchased (for investment) in 1940 for $5,000, for other real estate (to be held for productive use in trade or business) which has a fair market value of $6,000, and he receives in addition $2,000 in cash. The gain from the transaction is $3,000, but is recognized only to the extent of the cash received of $2,000.

(c) Consideration received in the form of an assumption of liabilities is to be treated as "other property or money" for the purposes of so much of section 112 (c) as relates to section 112 (b) (1) and (2). As to the proper treatment of such consideration for the purposes of so much of section 112 (c) as relates to section 112 (b) (3), see § 39.112 (g)-4 and so much

of section 112 (c) as relates to section 112 (b) (5), see section 112 (k).

(d) See section 113 (a) (6) for the basis for determining the gain or loss from the subsequent sale of the property received in exchanges such as described in this section.

(e) As to the receipt of other property or money on an exchange of stock or securities in connection with a section 112 (g) reorganization, see § 39.112 (g)-4; or in connection with a section 112 (b) (10) reorganization, see § 39.112 (l)-1. As to distributions in pursuance of a plan or reorganization which have the effect of a taxable dividend, see § 39.112 (g)-4, in the case of a section 112 (g) reorganization, or § 39.112 (l)-1, in the case of a section 112 (b) (10) reorganization."

Code of Federal Regulations, Revised 1953, page 612.

"§ 39.112 (c)-1 *Nonrecognition of loss.* (a) Section 112 (c) provides that in no event shall a loss be recognized from a tax-free exchange of property under section 112 (b) (1) to (5), inclusive, or section 112 (b) (10), notwithstanding the fact that there is received in the exchange other property or money in addition to property permitted to be received without recognition of gain or loss."

Code of Federal Regulations, Revised 1953, page 612.

"§ 39.112 (g)-4 *Exchanges in reorganization for stock or securities and other property or money.* (a) If in an exchange of stock or securities in a corporation a party to a reorganization, in pursuance of the

plan of reorganization, for stock or securities in the same corporation or in another corporation a party to the reorganization, there is received by the taxpayer other property (not permitted to be received without the recognition of gain) or money, then

(1) As provided in section 112 (c) (1), the gain, if any, to the taxpayer will be recognized in an amount not in excess of the sum of money and the fair market value of the other property, but

(2) The loss, if any, to the taxpayer from such an exchange is not to be recognized to any extent (see section 112 (e)).

(b) The application of paragraph (a) of this section may be illustrated by the following example:

Example. A, in connection with a reorganization, in 1952, exchanges a share of stock in the X Corporation purchased in 1929 at a cost of $100 for a share of stock of the Y Corporation (a party to the reorganization), which has a fair market value of $90, plus $20 in cash. The gain from the transaction is $10 and is recognized and taxed as a gain from the exchange of property. But see section 117. However, if the share of stock received had a fair market value of $70, the loss from the transaction of $10 would not be recognized."

Code of Federal Regulations, Revised 1953, page 619.

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In the Supreme Court of the United States

OCTOBER TERM, 1961

No. 60

GROVER D. TURNBOW AND RUTH H. TURNBOW,
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the Tax Court (R. 29–42) is reported at 32 T.C. 646. The opinion of the court of appeals (R. 54–64) is reported at 286 F. 2d 669.

JURISDICTION

The judgment of the court of appeals was entered on December 5, 1960 (R. 65). The petition for a writ of certiorari was filed on March 2, 1961, and was granted on May 15, 1961 (R. 66). The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

Petitioner exchanged stock in one corporation for stock in another corporation plus cash in a transac-

tion that did not qualify as a "reorganization" as defined in § 112(g)(1) of the Internal Revenue Code of 1939. Section 112(b)(3) provides for nonrecognition of gain if, "in pursuance of [a] plan of reorganization," stock or securities are exchanged "solely for stock or securities * * * in another * * * party to the reorganization." Section 112(c)(1) provides that, if an exchange would be within § 112(b)(3) "if it were not for the fact that the property received in exchange consists not only of property permitted by [§ 112(b)(3)] * * * to be received without the recognition of gain, but also of other property," the gain will be recognized only to the extent of the "other property." The question is whether, notwithstanding that there was no reorganization, the fact that there would have been a reorganization (under § 112(g)(1)(B)) if petitioner had received the stock but not cash, entitles him, under § 112(c)(1), to have his gain recognized only to the extent of the cash. The specific questions of statutory interpretation on which that question turns are:

1. Whether, as used in § 112(c)(1), "property permitted by [§ 112(b)(3)] * * * to be received without the recognition of gain" means "stock or securities in * * * a party to a reorganization" (§ 112(b)(3)) or also includes stock in a corporation not a party to a reorganization.

2. Whether the assumption that the "other property" was not received, made under § 112(c)(1) to determine whether the exchange "would be" within § 112(b)(3), may be utilized to satisfy not only the "solely" requirement of § 112(b)(3) but also the

requirements of a "reorganization" as defined in § 112(g)(1)(B).

STATUTE INVOLVED

Sections 112 and 113(a) (6) and (7) of the Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.) are set forth in relevant part in the Appendix, *infra*. pp. 69–75.

STATEMENT

Petitioner[1] owned all of the outstanding stock (5,000 common shares) of the International Dairy Supply Company ("Supply"), a Nevada corporation engaged mainly in furnishing, under government contracts, reconstituted milk products for overseas use. In 1952, pursuant to an agreement,[2] he transferred all of the Supply stock to Foremost Dairies, Inc. ("Foremost"), a New York corporation engaged in processing and distributing dairy products. In exchange he received $3,000,000 in cash and 82,375 shares of Foremost common stock (a minority interest) having a fair market value of $1,235,625 ($15 per share). Petitioner's basis in the Supply stock was $50,000, and his expenses in connection with the transfer were $21,933.06. Accordingly, on the total receipts of $4,235,625, petitioner's gain was $4,163,691.94 (R. 25–27, 30–36).

In his income tax return for 1952, petitioner, treating the gain as recognizable only to the extent of the cash received, reported a long-term capital gain of

[1] Grover D. Turnbow will be referred to as the sole petitioner, his wife being a party only because a joint return was filed.

[2] The agreement also included another exchange of stock not involved here.

$2,984,992.77 ($3,000,000 less claimed expenses). The Commissioner determined that the entire gain was recognizable and asserted a deficiency (R. 35–36). The Tax Court held that the gain was recognizable only to the extent of the cash (R. 36–42). The court of appeals reversed, holding that the entire gain was recognizable (R. 54–64).

SUMMARY OF ARGUMENT

Petitioner, the sole stockholder of the Supply corporation, transferred all of his stock to the Foremost corporation in exchange for $3,000,000 in cash and Foremost voting stock worth $1,235,000. The question is whether his gain on the exchange ($4,163,000) is recognizable in full or only to the extent of the cash received. It is admittedly recognizable in full unless §§ 112(b)(3), 112(c)(1) and 112(g)(1)(B) of the Internal Revenue Code of 1939 operate to make part of the gain nonrecognizable.

Section 112(g)(1)(B), one of the six definitions of a "reorganization," defines a so-called "B" reorganization as:

> [§ 112(g)(1)] * * * (B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of at least 80 percentum of the * * * stock of another corporation * * *.

Petitioner admits that, while Foremost acquired more than 80% of the Supply stock, the transaction failed to qualify as a "B" reorganization because it did not give "solely * * * voting stock" in exchange, the

consideration given being over 70% in cash and less than 30% in voting stock.

Section 112(b)(3), the basic "nonrecognition" provision involved, prescribes the major consequence of a transaction's qualifying or not qualifying as a reorganization:

> [§ 112(b)(3)] *Stock for stock on reorganization.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

Petitioner admits that his exchange was not within that provision, since it was neither incident to, nor were the stocks exchanged in parties to, a "reorganization." And since none of the property received consisted of "stock or securities *in* * * * *a party to a reorganization*," it did consist "solely" of such property.

That much being admitted, petitioner's argument cannot be, and is not, that the transaction *was* a reorganization; rather it is that it is not *necessary* to have a reorganization in order for an exchange of stock in one corporation for stock in another to be tax-free. That argument is based exclusively upon petitioner's construction of § 112(c)(1), the so-called "boot" provision, which provides:

> [§ 112(c)(1)] If an exchange would be within the provisions of * * * [§ 112(b)(3) or several other provisions] if it were not for the fact that the property received in exchange consists not only of property permitted by

> [§ 112(b)(3)] * * * to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

In the government's view, that provision is applicable only if some of the property received actually is "stock or securities in * * * a party to a reorganization" and some is not, so that the only reason the exchange failed to qualify under § 112(b)(3) was that the receipts did not consist "solely" of the permitted kind of property. It applies, in short, only if there is in fact a reorganization. We will show that that interpretation, adopted by the Ninth Circuit in this case, is required by the statute, the policy underlying it, its history, its relationship to cognate provisions, and the regulations interpreting it. The contrary decision of the Seventh Circuit in *Howard* v. *Commissioner*, universally criticized by tax commentators, is unsupportable.

1. The government's interpretation is required by the words of the statute. For purposes of determining its applicability, § 112(c)(1) divides the property received into two categories: (1) "property permitted by [§ 112(b)(3)] * * * to be received without the recognition of gain"; and (2) "other property or money." The test to be applied is whether the exchange "would be" within § 112(b)(3) if only the property in the first category had been received. If so, the gain is recognized only to the extent of the property in the second category.

Since the division of the property actually received between the stated categories necessarily *precedes* the making of the hypothetical "would be" determination, that division must be made on the basis of the actual, not the hypothetical, facts. And if none of the property received can properly be placed in the first category, it is evident that § 112(c)(1) can have no application, for it is only to the extent of such property that it permits the nonrecognition of gain.

The crucial first step, therefore, is to determine which of the properties received fits into the first category: "property permitted by [§ 112(b)(3)] * * * to be received without the recognition of gain." The answer here is that *none* of it does. The only property that § 112(b)(3) permits to be received without the recognition of gain is "stock or securities in * * * a party to a reorganization"—that is, not stock or securities in any corporation, but only those in one having a particular attribute, to wit, being a party to a reorganization. In this case, petitioner received, besides the obviously nonqualifying cash, only stock in a corporation (Foremost) that was *not* a party to a reorganization. That, on certain assumptions, it "would have been" is irrelevant, for the hypothetical "would be" test does not apply until *after* the categorization of the several properties received.

In short, the reason that § 112(c)(1) is inapplicable unless there is an actual reorganization is that, without one, none of the property received can qualify as "property permitted by [§ 112(b)(3)] * * * to be received without the recognition of gain."

2. Even accepting petitioner's unexplained assertion that the Foremost voting stock can, for purposes of § 112(c)(1), be treated as "permitted" property—and, hence, that the proper assumption to be made in applying the "but for" test is that he received the stock but not the cash—there is still a fatal defect in his argument. That error lies in petitioner's use of the no-cash assumption not only for purposes of determining whether § 112(b)(3) as such would apply (i.e., to overcome its "solely" requirement) but also for purposes of determining whether the transaction "would be" a reorganization under § 112(g)(1)(B).

Sections 112(b)(3) and (c)(1) deal only with individual "exchanges." Necessarily, therefore, the only assumption that § 112(c)(1) permits to be made is one about what the particular taxpayer received in the particular "exchange" in issue.

Section 112(g)(1)(B), on the other hand, is concerned, not with individual exchanges, but with the characterization of the entire planned transaction, which may, and typically does, involve numerous individual "exchanges." Specifically, the requirement of a "B" reorganization is, not that a particular stockholder receive solely voting stock for his shares, but that *all* of the stockholders participating in the "plan" receive solely voting stock. Thus, the assumption permitted by § 112(c)(1) (what a single stockholder received) has no logical relevance to the test of qualification as a "B" reorganization (what all the stockholders received).

It is essentially fortuitous in this case that, because petitioner happened to be a sole stockholder, what *he* received turns out to be identical with what the acquiring corporation gave, and petitioner acknowledges (by his reliance on *Howard,* which involved numerous stockholders) that the question of interpretation (how the § 112(c)(1) "assumption" is to be applied) cannot depend on that atypical circumstance. And in a case involving two (or more) stockholders, each of whom received some cash, the bar to using the § 112(c)(1) assumption to satisfy the reorganization definition (even hypothetically) would be plain: in determining the taxability of *each* stockholder's exchange (the only concern of § 112(c)(1)), the only assumption that could be made would be that *that* stockholder did not receive cash, and that would leave outstanding, as an independent bar to a "B" reorganization, the cash received by the *other* stockholders.

In short, the facts assumed under § 112(c)(1) are not relevant to the reorganization definitions (except fortuitously), and it therefore could not have been intended that the § 112(c)(1) assumption would be used to establish a hypothetical "reorganization." The assumption can properly be used only to satisfy the "solely" requirement of § 112(b)(3).

3. In every other of the several different kinds of exchanges to which § 112(c)(1) applies—e.g., exchanges of like-kind business property which fail to qualify under § 112(b)(1) because the exchange is not "solely" for the permitted kind of property—its function is limited to alleviating the "solely" re-

quirement of the basic nonrecognition provision. It would be anomalous to give it, in stock-for-stock exchanges, an effect totally different from its effect in all other exchanges.

4. That the "but for" clause of § 112(c)(1) does not permit hypothetical reorganizations to qualify is confirmed by the identical language of the "boot" provision applicable to corporations, § 112(d). For in that provision, the statement of the consequences of qualifying expressly assumes the existence of a reorganization (the consequences being made to depend upon whether the corporation distributes the boot "in pursuance of *the* plan of reorganization"), necessarily implying that only actual reorganizations could meet the test of qualification.

5. The reason that § 112(b)(3) and (c)(1) permit nonrecognition in an exchange of stock in one corporation for stock in another only if the two corporations are parties to a reorganization is evident. The policy of nonrecognition is that an exchange of "like-for-like" or a "mere change in the form of ownership" is not an appropriate event (not being sufficiently "closed") for the reckoning up of gain or loss. And the very function of the reorganization definitions is to prescribe when there exists a sufficient "continuity of interest" between two corporations to justify treating an exchange of their stocks as being a "mere change in the form of ownership." If that test if not satisfied (i.e., if there is no "reorganization"), the stocks exchanged are deemed to be no more "like" each other than the stocks of any other two unrelated corporations. There being no reorganiza-

tion in this case, the exchange, in policy terms, was not of "like-for-like-plus-boot" (as petitioner characterizes it) but of "unlike-for-unlike-plus-cash," the Foremost stock being as "unlike" the Supply stock as was the cash.

6. Petitioner's construction of § 112(c)(1) would, moreover, produce results inconsistent with the related basis provisions. Section 113(a)(7) gives corporations a "carryover" basis (i.e., the transferor's basis, appropriately adjusted for recognized gain or loss) for any property acquired "in connection with a reorganization," while in the absence of a reorganization the basis for any property acquired is "cost" (the fair market value of the property given in exchange) (§ 113(a)). The effect of those basis provisions is that the nonrecognition of the transferor's gain is obtained in a reorganization only at the price of the acquiring corporation having to take over the transferor's low basis for the property. Contrariwise, if there is no reorganization, the corporation acquires a "stepped-up" (fair market value) basis, but only at the price of the gain being recognized in full to the transferor. Petitioner's interpretation would destroy that relationship. Since the carryover basis provision would not be applicable, transactions failing to meet the solely-for-voting-stock requirement of the "B" definition would, in effect, be reorganizations *par excellence,* enjoying the best of both worlds (nonrecognition to the transferor *and* a "stepped-up" basis to the transferee). They would be treated "as though they were" reorganizations for

purposes of the desirable consequences of reorganizations (nonrecognition of gain) but as in fact not reorganizations for purposes of the undesirable consequences (carryover of basis). And since nonrecognition of gain and carryover of basis are the only two consequences of qualifying as a "B" reorganization, that preferential treatment would be the *only* consequence of failing to meet the solely-for-voting-stock requirement. The implication of petitioner's argument, in short, is that the reason Congress added the solely-for-voting-stock requirement to the reorganization definitions was to give *preferred* status to transactions that *failed* to meet it.

7. Petitioner's argument rests entirely upon the "but for" language of § 112(c)(1), to which he attributes a purpose, not only to alleviate the "solely" requirement of the several nonrecognition provisions, but also to extend nonrecognition to hypothetical reorganizations. The history of that provision shows that that was not, and could not have been, its purpose.

The original "boot" provision, in the Revenue Act of 1921, did not contain the "but for" language and provided simply that, if the property received consisted both of property "specified" in the nonrecognition provisions and of "other property", the gain should be recognized to the extent of the "other property," a directness of language that it was possible to employ because at that time the nonrecognition provisions did not contain the "solely" requirement. In the complete rewriting of those provisions in the Revenue Act of 1924, however, the basic nonrecogni-

tion provisions were all limited in terms to exchanges "solely" for the described kind of property. Since the presence of any other property would, under that wording, make the nonrecognition provisions altogether inapplicable, it was necessary to rephrase the "boot" provision to provide for *pro tanto* nonrecognition in exchanges that would have been within the basic provisions but for the failure to meet the newly-added "solely" requirement. The "boot" provision was, accordingly, rewritten in the "but for" form and it has remained unchanged ever since. The committee reports took no note of the change, except to refer to "minor changes in phraseology" in the nonrecognition provisions and to note that the "boot" provision of that Act "corresponds to [the equivalent section] of the existing law."

Not only, as that history shows, was the "but for" language not intended to have the effect petitioner attributes to it, but it *could not* have been so intended. The simple reason is that the solely-for-voting-stock requirement of the reorganization definitions (upon the interaction with which petitioner's interpretation of the "but for" language depends) was not then in existence and was, in fact, not added until ten years later. At the time of its adoption, the only purpose the "but for" language *could* have had was to alleviate the "solely" requirement of the basic nonrecognition provisions; there having been no intervening changes in that provision, that remains its only purpose today.

8. Final confirmation is provided by the Treasury Regulations, which explicitly adopt the interpretation of § 112(c)(1) urged here.

ARGUMENT

INTRODUCTION

Petitioner, the sole stockholder of the Supply corporation, transferred all of the Supply stock to the Foremost corporation in exchange for $3,000,000 in cash and Foremost voting stock worth $1,235,000. The court of appeals, upholding the Commissioner, held that the entire gain ($4,163,000, after expenses) was taxable. Petitioner contends that the gain should be recognized only to the extent of the $3,000,000 in cash received and should not be recognized to the extent that it is represented by the Foremost voting stock received on the exchange. The additional gain would, under petitioner's view, be recognized only when he ultimately disposes of the Foremost stock.

An exchange of property for other property is, of course, ordinarily a fully taxable event on which the entire gain must be recognized (§ 112(a)),[3] and a claim for nonrecognition must be based upon a specific statutory exception. The provisions upon which petitioner relies are § 112(g)(1)(B), one of the definitions of a "reorganization"; § 112(b)(3), making certain exchanges pursuant to a reorganization "tax-free" (i.e., providing for nonrecognition of gain or loss); and § 112(c)(1), governing the effect of the receipt of "boot" in exchanges that would otherwise be tax-free. It is upon the interpretation and interaction of those three provisions that the question in this case turns.

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[3] Unless otherwise indicated, all references are to the Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.).

On the first step in the analysis, the Tax Court, the court of appeals, the petitioner, and the government are all agreed—namely, that the transaction between petitioner and Foremost whereby Foremost acquired all the stock of Supply did *not* qualify as a "reorganization" under § 112(g)(1)(B). A so-called "B" reorganization is defined by that section as:

> * * * (B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of at least 80 percentum of the * * * stock of another corporation * * *.

In this case, Foremost, the acquiring corporation, did acquire more than 80% of the stock of Supply (in fact, 100%), but it did not give "solely" Foremost voting stock in exchange, the total consideration being over 70% in cash and less than 30% in the form of voting stock. Thus the transaction patently, and admittedly, failed to qualify as a "reorganization" under the only revelant definition.

It is equally clear, and equally admitted, that petitioner's exchange of his Supply stock for Foremost stock and cash did not qualify as a tax-free exchange under § 112(b)(3), which provides:

> (3) *Stock for stock on reorganization.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

An exchange qualifies under that provision, it may be seen, only if:

(1) the exchange is incident to a reorganization;

(2) the taxpayer transfers stock or securities in a party to the reorganization;

(3) the taxpayer receives stock or securities in a party to the reorganization; and

(4) the property received consists "solely" of such stock or securities.

The exchange in this case met none of those four requirements. There being no "reorganization," the exchange was not incident to, and neither the Supply stock transferred nor the Foremost stock received was in a party to, a reorganization. And since petitioner received *no* "stock or securities in * * * a party to a reorganization," he obviously did not receive "solely" such stock or securities.

So much, as we have noted, is not in dispute. The dispute centers entirely upon the so-called "boot" provision, § 112(c)(1), which provides:

> (1) If an exchange would be within the provisions of subsection (b) (1), (2), (3), or (5), or within the provisions of subsection (l), of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph or by subsection (l) to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

Petitioner contends that that provision makes his gain taxable only to the extent of the cash received notwithstanding that there was no reorganization and

the exchange met none of the requirements of § 112 (b)(3). The government contends, on the other hand, that the "boot" provision does not apply unless the first three requirements of § 112(b)(3) are independently satisfied (the exchange is incident to a reorganization and the taxpayer both gives and receives stock or securities in a party to the reorganization) and the only bar to qualification under § 112(b)(3) is the fact that the taxpayer received other property *in addition* to stock or securities in a party to the reorganization. In brief, the opposing interpretations of § 112(c)(1) are as follows:

In the government's view, § 112(c)(1) first divides the property received into two categories—(1) "property permitted by [§ 112(b)(3)] * * * to be received without the recognition of gain"; and (2) "other property or money"—and then provides that, if the exchange "would be" within § 112(b)(3) if only the property in the first category had been received, the gain is to be recognized only to the extent of the property in the second category. If that is a proper reading, the provision cannot apply unless *some* of the property received in fact belongs to the first category. In turn, the only property that § 112(b)(3) "permits" to be received without the recognition of gain (the first category) is, in express terms, "stock or securities in * * * a party to a reorganization". It follows that *none* of the property received can qualify in the first category unless there is in fact a "reorganization." In this case Foremost was not a party to a reorganization. Therefore the Foremost voting stock does not qualify for the first category any better than

the cash. Rather all of the property received belonged to the second category, "other property or money," and the second step—whether the exchange "would be" within § 112(b)(3) if only the property in the first category had been received—is never reached.

Petitioner contends, on the other hand, that the Foremost voting stock, though not stock in a party to a reorganization, belongs nevertheless to the first category, "property permitted by [§ 112(b)(3] * * * to be received without the recognition of gain," and only the cash belongs to the second. The test, in his view, then becomes whether the exchange "would be" within § 112(b)(3) if he had received the *stock* but not the *cash*. He then contends that the assumption to be made in applying that test—that no cash was received—may be utilized not only to satisfy the "solely" requirement of § 112(b)(3) but also the requirements of a "reorganization" under § 112(g)(1)(B) (a step with which the government also disagrees). On those premises, petitioner reasons that "but for" the cash there would have been a reorganization under § 112(g)(1)(B) and the exchange would therefore have been within § 112(b)(3), thereby meeting the "but for" test of § 112(c)(1) and entitling him to have his gain recognized only to the extent of the "other property" (which, in his view, consists only of the cash).

The petitioner's interpretation of § 112(c)(1) as permitting a tax-free exchange of stock in one corporation for stock in another without there being a "reorganization" was that adopted by the Seventh Cir-

cuit in *Howard* v. *Commissioner*, 238 F. 2d 943, a decision that has been universally criticized by tax commentators[4] and prompted recommendations of corrective legislation from professional advisory groups.[5] The government's interpretation is that

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[4] See e.g., 3 Mertens, *Law of Federal Income Taxation* (Rev.), Sec. 20.147, fn. 84a; Surrey and Warren, *Federal Income Taxation* (1960 ed.) 1551-2; Rabkin and Johnson, *Federal Income Gift and Estate Taxation*, 3803; Bittker, *Federal Income Taxation of Corporations and Shareholders*, 387-388; Darrell, *The Use of Reorganization Techniques in Corporate Acquisitions*, 70 Harv. L. Rev. 1183, 1207, 1232 (1956-57); Donnelly, *Courts Wrongly Permit Boot in Old-Law Reorganizations*, 11 Journal of Taxation 138; (September, 1959); Leake, *Problems in Corporate Acquisitions*, 13 Tax Law Review 67, 74, 77; Kanter, *The Changing Complexion of the "B" Reorganization*, 45 A.B.A.J. 1317 (1959); Note, *Reorganizations—(B) Reorganization Exists Though Boot is Received*, 73 Harv. L. Rev. 1402 (1959-60); Note, *Recognition of Gain Limited to Cash Received Which Barred Reorganization Characterization*, 57 Columbia L. Rev. 591 (1957); McDonald and Willard, *Tax Free Acquisitions and Distributions*, 14 N.Y.U. Institute on Federal Taxation 859 (1956); Kanter, *C.A.-9 says boot makes B reorganization impossible; Turnbow conflicts with C.A.-7*, 14 Journal of Taxation, No. 4, p. 222, (April 1961); Merritt, *Tax-Free Corporate Acquisitions*, 53 Mich. L. Rev. 911 (1954-55); Comment, *Application of Boot Provisions to an Attempted (B) Reorganization*, 3 U.C.L.A. Law Rev. 415 (1961); cf. Note, *Taxation Shareholders Receiving only Stock Recognize no Gain in What Would Have Been a "B" Reorganization Except for the Presence of Boot*, 43 Va. L. Rev. 436 (1957).

[5] See *Revised Report of the Advisory Group on Subchapter C of the Internal Revenue Code of 1954 to accompany H. Rep. 4459*, 86th Cong., 1st Sess., pp. 66, 77, criticizing the *Howard* decision and recommending an amendment to the "boot" provision "to make clear that it operates only in a transaction which, independent of its provisions, qualifies as a reorganization." The American Bar Association has endorsed the ad-

adopted by the Ninth Circuit in this case. It was to resolve the conflict between those two decisions, on a question of basic and continuing importance to the scope of the reorganization and nonrecognition provisions,[6] that the case was brought here.

I

SECTION 112(C)(1) LITERALLY APPLIES ONLY IF SOME PART OF THE PROPERTY RECEIVED IS ACTUALLY, NOT HYPOTHETICALLY, OF THE KIND DESCRIBED IN THE UNDERLYING NONRECOGNITION PROVISION, WHICH IN THE CASE OF SECTION 112(B)(3) REQUIRES THAT THERE BE AN ACTUAL, NOT A HYPOTHETICAL, REORGANIZATION

In every other of the several different kinds of exchanges to which § 112(c)(1) applies—e.g., exchanges of like-kind business property which fail to qualify under § 112(b)(1) because the exchange is not "solely" for the permitted kind of property—its function, as we will later demonstrate (see Point III, *infra*), is necessarily limited to alleviating the "solely" requirement of the basic nonrecognition provision. We will show that, properly interpreted, its function is similarly limited in stock-for-stock exchanges—i.e., that it applies only when there *is* a reorganization and the taxpayer *does* receive "stock

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visory committee's recommendation, urging that the amendment was "advisable for the sake of certainty in view of the language of *Howard* * * *, which implied the contrary, despite the generally held view that the rule established by this proposed amendment was already applicable" (106 Cong. Rec. p. A1462 (Daily Issue, Feb. 23, 1960)).

[6] Although this case is governed directly by the 1939 Code, petitioner's argument would be equally applicable under the 1954 Code. See §§ 354(a)(1), 356(a)(1), and 368(a)(1)(B) of the 1954 Code.

or securities in * * * a party to the reorganization" but *also* receives other property. Such an exchange—which could readily occur in several different kinds of reorganizations[7]—would fail to qualify under § 112(b)(3) because it was not "solely" for the permitted kind of property. The "boot" provision, however, alleviates the "solely" requirement by providing that, if the exchange would have been within § 112(b)(3) but for the fact that other property was received in addition to the permitted property, the gain

[7] The most common type would be a "statutory merger or consolidation" qualifying as an "A" reorganization, but the "D", "E", and "F" definitions likewise contain no specific limitation on the kind of property that may be transferred. See § 112(g)(1), *infra*, p. 72. It cannot be said with certainty, for that matter, that there could not be "other property" in a transaction qualifying as a "B" or "C" reorganization. While those definitions do literally require that "solely * * * voting stock" be given, that requirement raises questions of interpretation (not involved in this case) that have not yet been finally resolved. For example, since § 112(g)(1)(B) requires only that 80% of the stock of another corporation be acquired, it is arguable that that definition is met if the consideration allocable to at least 80% of the stock consists of voting stock, notwithstanding that the acquiring corporation also acquires additional shares (e.g., from dissenting stockholders) for money or other property. That was in fact the situation in the *Howard* case, in which the acquiring corporation gave solely voting stock for 81% of the shares but gave cash to a dissenting minority for the remaining 19%. While the Seventh Circuit held that the cash given the minority precluded a "B" reorganization, the question is a debatable one and there is no assurance that other courts would follow that decision. In this case, of course, since less than 30% of the consideration was in the form of voting stock, that question is not raised. The question involved here goes rather to the second holding in the *Howard* case—namely, that the exchanges were tax-free despite the court's holding that there was *not* a reorganization.

is to be recognized only to the extent of the "other property." What we propose to prove is that that is the *only* function of § 112(c)(1) and that it does not do double service by alleviating not only the "solely" requirement of § 112(b)(3) but also the requirements of a "reorganization" under § 112(g)(1)(B).

1. Limited to its interaction with § 112(b)(3), § 112(c)(1) provides:

> (1) If an exchange would be within [§ 112(b)(3)] * * * if it were not for the fact that the property received in exchange consists not only of property permitted by [§ 112(b)(3)] * * * to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

In order to separate the steps involved in applying that provision, it can, we think, fairly be restated in this manner:

> (A) If there is received in an exchange both:
> (i) "property permitted by [§ 112(b)(3] * * * to be received without the recognition of gain" and
> (ii) "other property or money"; and
> (B) if the exchange "would be" within § 112(b)(3) if only the property in the first category had been received; then
> (C) the gain shall be recognized only to the extent of the property in the second category.

That restatement makes clear that the crucial first step is the division of the property received between the

two stated categories: (i) "permitted" property; and (ii) "other" property. Unless *some* of the property received comes within the first category, § 112(c)(1) can have no application, for it is only to the extent of such property that it permits the nonrecognition of gain. That requirement, moreover, must be actually, not hypothetically, satisfied. It is only after it appears that some of the property belongs to the first category that one reaches the hypothetical question—namely, whether the exchange would be within § 112(b)(3) if only that property had been received.

The first question of interpretation, therefore, is what is meant by "property permitted by [§ 112(b)(3)] * * * to be received without the recognition of gain". What it means, we suggest, is clear beyond doubt, for § 112(b)(3) describes in express terms what property it "permits" to be received without the recognition of gain—namely, "stock or securities in * * * a party to a reorganization." It is not "stock" in any corporation, but only stock in a corporation having a particular attribute—i.e., being a party to a reorganization—that § 112(b)(3) "permits" to be received without the recognition of gain.[8]

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[8] Obviously, for example, if in an exchange incident to the merger of the *X* and *Y* corporations (an "A" reorganization), a stockholder of *X* received, in exchange for his stock, property consisting of *Y* stock, cash, and some General Motors stock that *Y* happened to own, the only part of the receipts that would qualify as "property permitted by [§ 112(b)(3)] * * * to be received without the recognition of gain" would be the *Y* stock. The General Motors stock, though "stock", would not be stock "in * * * a party to the reorganization", and would have to be placed, like the cash, in the second category, "other property or money." Plainly, then, "in * * * a party to a reorganization"

Since there must be some property belonging to the first category that § 112(c)(1) establishes—"property permitted by [§ 112(b)(3)] * * * to be received without the recognition of gain"—for that section to be applicable; and since the only property meeting that description is "stock or securities in * * * a party to a reorganization"; it follows that § 112(c)(1) does not apply unless the taxpayer actually, not hypothetically, receives some "stock or securities in * * * a party to a reorganization." Without that predicate being established, the hypothetical question—would the exchange be within § 112(b)(3) if only the property so qualifying had been received—is never reached. In short, § 112(c)(1), no less than § 112(b)(3), is inapplicable unless there is in fact a "reorganization."

2. In this case, there was admittedly no reorganization. Foremost was therefore not a "party to a reorganization", and its stock was not "stock * * * in * * * a party to a reorganization." Thus none of the property petitioner received, neither the cash nor the Foremost stock, was "property permitted by [§ 112(b)(3)] * * * to be received without the recognition of gain." It was *all* "other property." Plainly § 112(b)(3) can have no application and petitioner's gain was therefore recognizable in full.

The explanation of the apparent plausibility of petitioner's argument is that it ignores that crucial first step in the application of § 112(b)(3). It starts with

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is an essential part of the description of the *kind* of property qualifying, for purposes of § 112(c)(1), as "property permitted by [§ 112(b)(3)] * * * to be received without the recognition of gain."

the second step, the hypothetical question, and in stating that question simply assumes that "voting stock of Foremost" qualifies as "property permitted by [§ 112(b)(3)] * * * to be received without the recognition of gain. Thus, at the very opening of his argument (Br. 9), petitioner states the question as being whether the exchange would have been within § 112(b)(3) "'if it were not for the fact that' the property received in exchange consisted not only of [i] voting stock of Foremost but also of [ii] money." Petitioner's whole case, we submit, lies in that unheralded and unexplained substitution of "voting stock of Foremost" in the place of the statutory phrase, "property permitted by [§ 112(b)(3)] * * * to be received without the recognition of gain". And the answer to his case is that "voting stock of Foremost" in fact does *not* qualify as "permitted" property, but belongs rather to the second category, "other property or money."[9]

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[9] Petitioner's treatment of the Foremost voting stock as being the "permitted" property and of the cash as being the "other property" is made even colorable only by the circumstance that § 112(b)(3) at least mentions "stock" (albeit stock in "a party to a reorganization") while it does not refer at all to "money." Even that superficial basis for allocation would disappear, however, with the case being no different, had he received *nonvoting* stock instead of the cash. While that would equally have precluded a "B" reorganization (which requires solely *voting* stock), there is nothing in § 112(b)(3) (which lumps together all "stock or securities in * * * a party to a reorganization") or § 112(c)(1) which suggests the slightest possible distinction between different kinds of stock in the same corporation. The voting and the nonvoting stock would be *equally* close to being "property permitted by [§ 112(b)(3)] * * * to be received without the recognition of gain." If one qualified,

Although petitioner's brief does not address itself to the question, his unstated premise seems to be that "voting stock of Foremost" can be placed in the "permitted" category because it "would have been" permitted property if nothing else had been received. But it is not at that step that the "hypothetical" determination is to be made. The only hypothetical step is in determining whether the exchange would have been within § 112(b)(3) if only the "permitted" property and not the "other property" had been received. Necessarily, the division of the property between the "permitted" property and the "other property" must be made before that step is reached.

To put the point another way, petitioner seeks to have § 112(c)(1) do double service. First, he wants it hypothetically to convert a transaction that was not a reorganization into a reorganization so that some of the property he receives will qualify as "property permitted by [§ 112(b)(3)] * * * to be received with-

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even hypothetically, as "stock * * * in * * * a party to a reorganization", so must the other, since it is equally "stock" and is in the same corporation. In such a case, surely, the receipts would have have to be treated either as *all* "permitted" property (which they obviously could not be, or there would be no need to resort to the "boot" provision) or as *all* "other" property (in which event, resort to the "boot" provision would be fruitless). The point of the supposed case is that, there being no distinction at all between two kinds of stock for purposes of §§ 112(b)(3) and (c)(1), it makes obvious the fact, equally true here, that without a reorganization *none* of the property received can qualify under § 112(c)(1) as "property permitted by [§ 112(b)(3)] * * * to be received without the recognition of gain."

out the recognition of gain." Second, he wants it to allow the "permitted" part of the property to be received tax-free as if the "other" property was not received. Section 112(c)(1) permits the second hypothesis—i.e., to assume that the "other property" was not received in order to satisfy the "solely" requirement of § 112(b)(3). It does not permit one to assume a hypothetical reorganization so as to satisfy the requirement that some of the property received be of the kind permitted by § 112(b)(3) to be received without the recognition of gain—i.e., to satisfy the "reorganization" requirement of § 112(b)(3).

From the terms of § 112(c)(1) itself, therefore, it is plain that it becomes operative only when some of the property received is of the kind described in the underlying nonrecognition provision and some is not. Its meaning, and only meaning, is that if the property received consists in part of qualifying property (i.e., that described in the underlying provision) and in part of nonqualifying property, and the other requirements of the nonrecognition provision are met, the qualifying property may be received "tax-free" and the gain will be taxed only to the extent of the nonqualifying property. It neither adds to nor detracts from the qualification of property as the *kind* of property permitted to be received without the recognition of gain by the underlying nonrecognition provision; it only preserves that qualification notwithstanding the presence of additional, nonqualifying, property. None of the property received in this case having qualified as the kind permitted by § 112

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(b)(3) to be received without the recognition of gain, the "boot" provision is irrelevant.

II

AN INDEPENDENT REASON WHY SECTION 112(C)(1) CANNOT BE MADE USE OF TO ESTABLISH A HYPOTHETICAL REORGANIZATION IS THAT THE ASSUMPTION THAT A PARTICULAR STOCKHOLDER DID NOT RECEIVE "OTHER PROPERTY" IN A PARTICULAR EXCHANGE IS LOGICALLY IRRELEVANT TO QUALIFICATION OF THE TRANSACTION AS A WHOLE, NORMALLY INVOLVING MANY EXCHANGES, AS A REORGANIZATION

There is a second error in petitioner's argument which, while less obvious than that discussed in the first point, is no less fundamental. To demonstrate that, we will accept petitioner's statement of the test as being whether the exchange would have been within § 112(b)(3) but for the fact that petitioner received not only Foremost voting stock but also cash. That is, we will accept petitioner's premise that, in determining hypothetical qualification of the exchange under § 112(b)(3), it is proper to assume that he received solely the voting stock and no cash. Even so, we submit, the method employed by petitioner in applying that test (i.e., in making the hypothetical determination) is improper.

Petitioner contends that the assumption made under § 112(c)(1) can be utilized, not only to satisfy the "solely" requirement of § 112(b)(3), but also to establish a hypothetical reorganization under § 112(g)(1)(B) and thereby satisfy the "reorganization" requirements of § 112(b)(3). He reasons that if only voting stock had been received the transaction "would have been" a reorganization under § 112(g)(1)(B) (acquisition by one corporation (Foremost), in ex-

change "solely" for its voting stock, of more than 80% of the stock of another corporation (Supply)); and hence the exchange would have been pursuant to, and involved stock in parties to, a "reorganization," thereby satisfying § 112(b)(3). It is our position, to the contrary, that the assumption made under § 112 (c)(1) cannot be utilized to satisfy, even hypothetically, the requirements of a "reorganization" under § 112(g)(1)(B) and that its function is limited to satisfying the "solely" requirement of § 112(b)(3) itself.

The reason that is so is that §§ 112(b)(3) and (c)(1), on the one hand, and § 112(g)(1)(B), on the other, are concerned with transactions of an entirely different scope, and the assumptions made for purposes of the former have no logical relevance to the latter. Although one of their requirements is that the particular exchange be "pursuant to" an over-all plan, §§ 112(b)(3) and (c)(1) apply only to individual exchanges—i.e., they specify the tax consequences of each exchange pursuant to the over-all plan. Any assumption that § 112(c)(1) permits to be made is therefore necessarily limited to an assumption about what was received by the single recipient in the particular "exchange" in issue. Section 112(g)(1)(B), on the other hand, is concerned with the characterization of the "plan" as a whole, which may, and usually does, consist of many individual "exchanges"; qualification under it depends, not upon what a particular participant receives, but upon what all of the participants receive—or, even more precisely, upon what the acquiring corporation gives to all the par-

ticipants (which must be solely voting stock). Hence the fact assumed under § 112(c)(1) (what a single participant received) is logically irrelevant to qualification as a reorganization under § 112(g)(1)(B) (which turns upon what all the participants received).

The significance of that distinction is obscured in this case by the fortuitous, and atypical, fact that, since petitioner alone owned all of the Supply stock, the entire "plan" consisted of but a single "exchange" and what petitioner received and what Foremost gave turn out to be identical. Since petitioner's argument is not limited to such a unique case,[10] however, we can, to demonstrate the importance of that distinction, properly assume a transaction, otherwise identical to this case, involving two equal shareholders, *X* and *Y*, each of whom received in exchange for his stock precisely half of what petitioner received (i.e., 30% in Foremost voting stock and 70% in cash).

Under petitioner's statement of the test, whether the gain taxable to *X* is to be limited under § 112(c)(1) to the cash he received depends upon whether his "exchange" would be within § 112(b)(3) if it were not for the fact that "the property received in exchange consisted not only of voting stock of Foremost but also of money." The answer, clearly, is that it would not be. The only assumption that test permits to be made is that *X* (the party to

[10] Witness his reliance on *Howard*, which involved numerous stockholders.

the "exchange") received no cash, and that assumption still leaves outstanding the cash received by *Y*, which by itself is sufficient to prevent the transaction from qualifying as a "reorganization" under § 112(g)(1)(B) (which requires that *all* of the participants receive solely voting stock). In short, even if we assume that *X* received no cash, the fact that *Y* received cash still prevents *X*'s exchange from qualifying, even hypothetically, under § 112(b)(3). Needless to say, the same would be true of *Y*'s exchange, since in applying § 112(c)(1) to his exchange, the cash received by *X* would be the barrier.

Thus to give § 112(c)(1) the effect petitioner attributes to it, in any case involving more than one stockholder, requires not only the unexplained substitution of "voting stock in a corporation not a party to a reorganization" for the statutory phrase, "property permitted by [§ 112(b)(3)] * * * to be received without the recognition of gain" (discussed in Point I), but also a still further distortion so that it would read:

> If an exchange would be within [§ 112(b)(3)] * * * if it were not for the fact that the property received in exchange [not only in that exchange but in all other exchanges pursuant to a common plan] consists not only of [voting stock in a corporation not a party to a reorganization] but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and

> the fair market value of such other property [to the extent that such money or property is received by him].[11]

That is, indeed, precisely the effect of the Seventh Circuit's application of § 112(c)(1) in the *Howard* case, where the particular taxpayers involved had in fact received *solely* voting stock and § 112(c)(1) was utilized exclusively for the purpose of assuming away the cash received by *other* stockholders. It is also, in the end, the interpretation for which petitioner contends, for he is understandably unwilling to claim an interpretation that would forego *Howard* and which would be applicable only in the case where a single stockholder happens to receive all of the disqualifying cash.[12]

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[11] Having expanded the "other property or money" to include that received by all the participants, the last qualification must be added to prevent the cash received by other participants from being taxed to "the recipient" in the single "exchange" to which § 112(c)(1) is being applied.

[12] The absurdity of such a distinction can be demonstrated by a case involving two stockholders, in which *X* receives solely voting stock and *Y* receives both voting stock and cash. If § 112(c)(1) permitted a taxpayer to assume away his own cash for purposes of showing a hypothetical "B" reorganization but not the cash received by others, it would produce the bizarre result that *X*, who received solely stock, would be fully taxed (since he could not assume away *Y*'s cash), while *Y* would be entitled to nonrecognition to the extent of the stock he received (since he could assume away his own cash). In short, if the no-boot assumption can be utilized to create a hypothetical "reorganization" (and not simply to satisfy the "solely" requirement of § 112(b)(3)), the assumption cannot rationally be limited to the "boot" received by the particular taxpayer but must be extended to assume away the "boot" in all the exchanges pursuant to a common plan. Otherwise, the single stockholder who received all the "boot" would be preferred over those who received none.

III

IN EVERY OTHER OF ITS SEVERAL APPLICATIONS, SECTION 112(c)(1), WHILE ALLEVIATING THE "SOLELY" REQUIREMENTS OF THE VARIOUS NONRECOGNITION PROVISIONS, ACCORDS NONRECOGNITION ONLY TO THE RECEIPT OF PROPERTY INDEPENDENTLY QUALIFYING AS THE KIND OF PROPERTY DESCRIBED IN THE BASIC PROVISION, AND IT WOULD BE ANOMALOUS TO GIVE IT AN ENTIRELY DIFFERENT EFFECT IN ITS APPLICATION TO STOCK-FOR-STOCK EXCHANGES

We have thus far shown that, in its interaction with § 112(b)(3), the only function § 112(c)(1) performs is to alleviate the requirement that the exchange be "solely" for the kind of property described in § 112(b)(3); it does not make tax-free the receipt of any property that does not independently qualify as the kind of property permitted by that provision to be received without the recognition of gain (i.e., "stock or securities in * * * a party to a reorganization"). To confirm that interpretation, we will show that that is also, and even more obviously, the only function it has in its several other applications.

Section 112(b)(3) (exchanges of stock for stock incident to a reorganization) is, of course, only one of several provisions providing for nonrecognition of gain or loss in various kinds of exchanges, and § 112(c)(1) serves as the "boot" provision for all of them (with one exception to be noted later, see Point IV). The other provisions to which it applies provide for nonrecognition of gain or loss in the following kinds of exchanges:

> § 112(b)(1): exchange of business or investment property "solely" for business or investment property "of a like kind."
>
> § 112(b)(2): exchange of stock "solely" for stock in the same corporation.

§ 112(b)(5): transfer of property to a controlled corporation in exchange "solely" for stock or securities of that corporation.

§ 112(l): exchange of stock or securities "solely" for stock or securities of a successor corporation pursuant to a court-approved plan in insolvency (e.g., Chapter X) proceedings.

Since each of those provisions, like § 112(b)(3), contains the "solely" requirement, an exchange in which the property received consisted in part of the kind of property described in the relevant provision (e.g., like-kind business property, in the case of § 112(b)(1)) and in part of other property would fail to qualify and, if it were not for the "boot" provision, the entire gain would be recognized. Section 112(c)(1) avoids that result, providing that in such a case the gain will be recognized only to the extent of the other property.

In each of those applications, the only function that § 112(c)(1) performs is to alleviate the requirement that the exchange be "solely" for the described kind of property. It does not alleviate the requirement that the part of the receipts claimed to be "tax-free"[13] be the kind of property described in the

[13] As used in this context, "tax-free" implies only that the gain is not recognized to the extent that it is attributable to that part of the receipts. The property that is said to be received "tax-free" enters into the computation of the gain, but the gain is "recognized" (i.e., taxed) only to the extent of the "other property." If there is no "other property," then of course the gain is not recognized at all. That ultimately is the only difference between an exchange qualifying under a basic nonrecognition provision (e.g., § 112(b)(3)) and one qualifying under the "boot" provision, and in common parlance

underlying nonrecognition provision. If, for example, business property were exchanged for other business property plus cash, § 112(c)(1) would operate to postpone recognition of any part of the gain only if the business property received independently met the description in § 112(b)(1) of the *kind* of property that may be received tax-free (namely, business property "of a like kind"). If the business property received were not "of a like kind" within the meaning of § 112(b)(1), the "boot" provision would be of no avail.

The important point to observe is that in the application of § 112(c)(1) to, say, a § 112(b)(1) type of exchange—and the same is true of its application to § 112 (b)(2), (b)(5), and (l) exchanges—there is not involved a hypothetical determination of what "would be" like-kind property if the facts were different. Part of the property received must *actually* be "of a like kind"—or be stock of the same corporation, or stock of a controlled corporation, or stock of a corporation emerging from Chapter X proceedings—and only if it is, does the "boot" provision permit nonrecognition even in part.

Under our interpretation of § 112(c)(1) as applying to stock-for-stock exchanges only if there is a "reorganization," its function in such exchanges is precisely the same as in every other kind. The typical case is a merger qualifying as a "reorganization" under § 112(g)(1)(A) in which a stockholder of the

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they are equally referred to as "tax-free" exchanges, the caveat that the gain is recognizable to the extent of the "boot," if any, being implicit.

merged corporation receives stock in the surviving corporation plus cash. The stock received is "stock * * * in * * * a party to the reorganization" within the meaning of § 112(b)(3), but the exchange does not qualify under that provision since the property received does not consist "solely" of such stock. The "boot" provision applies, however, and makes the gain taxable only to the extent of the non-qualifying property—i.e., the cash. Here again the only effect of § 112(c)(1) is to overcome the "solely" requirement of the underlying nonrecognition provision. It operates to permit the property of the kind that § 112(b)(3) permits to be received tax-free to continue to be received tax-free notwithstanding the presence of the other property, while taxing the other property. There is exempted from tax only the property which actually meets the § 112(b)(3) description, not property which hypothetically "would" meet that description if the facts were different.

Our interpretation, then, gives to the "boot" provision in all of its applications—whether in interaction with subsection (b)(1), (b)(2), (b)(3), (b)(5), or (l)—a uniform, simple, and straightforward function. It does no more than provide that if *some but not all* of the property received is of the kind described in the relevant nonrecognition provision the gain will be recognized only to the extent of the nonqualifying property. It does not make something into a reorganization when it is not.

The effect petitioner would attribute to the "boot" provision in this case is, on the other hand, of an

entirely different order from its effect in every other case. For in this case not only did the property received by petitioner not consist "solely" of property of the kind described in § 112(b)(3) ("stock or securities in * * * a party to a reorganization") but, as we have seen, it did not consist at all of such property. Thus petitioner is relying on the "boot" provision not only to alleviate the "solely" requirement of the underlying nonrecognition provision—its only function in every other application—but for a second and entirely different function: namely, to extend tax-free treatment to property not of the kind described in the basic nonrecognition provision. In every other application, the "boot" provision operates to "save" property independently qualifying under the nonrecognition provision from losing its tax-free status because other property is also received; here it is claimed to confer tax-free status upon property which meets no part of the description of tax-free receipts in the underlying provision. It is at least unlikely, we suggest, that the "boot" provision was intended to have in one particular application a result so markedly different in kind from its effect in all other applications.

IV

THE COMPANION "BOOT" PROVISION GOVERNING ASSETS-FOR-STOCK EXCHANGES EMPLOYS THE SAME LANGUAGE AS SECTION 112(c)(1) BUT MAKES EXPRESS THE ASSUMPTION THAT ONLY "REORGANIZATION" EXCHANGES CAN QUALIFY, THUS CONFIRMING THAT INTERPRETATION OF SECTION 112(c)(1)

Under our interpretation §§ 112(b)(3) and 112(c)(1) make a reorganization prerequisite to the nonrecognition of gain (whether in whole or in part) in

stock-for-stock exchanges. That interpretation is confirmed by the companion provisions governing assets-for-stock exchanges by corporations (§§ 112(b)(4) and 112(d)) which, while otherwise identical to §§ 112(b)(3) and 112(c)(1), make express the assumption that only in reorganization exchanges can their requirements be met. Petitioner's interpretation makes these related sections essentially inconsistent.

The basic nonrecognition provision governing assets-for-stock exchanges is § 112(b)(4), which provides:

> No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

That provision, it may be seen, is in all respects parallel to § 112(b)(3) (governing stock-for-stock exchanges), the only difference being in the property the taxpayer transfers in the exchange.

The "boot" provision applicable to such exchanges is § 112(d), which provides:

> If an exchange would be within the provisions of subsection (b)(4) * * * if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—
>
> (1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the

> corporation shall be recognized from the exchange, but
>
> (2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

It is apparent that the "if" clause of § 112(d) is substantially identical to that of § 112(c)(1) (the "boot" provision involved in this case). The only difference appears in the "then" clause. That is to say, the test of qualification is identically stated in the two provisions, and the only difference is in the clauses prescribing the consequences of qualifying.

It is equally evident, however, that the provisions governing the consequences of qualifying under § 112(d) expressly assume the existence of a "reorganization." Two alternative consequences are stated, and which is applicable depends solely upon whether or not the corporation "receiving such other property or money distributes it *in pursuance of the plan of reorganization.*" Since there can be no "plan of reorganization" unless there is a "reorganization," the necessary assumption is that no exchange could qualify under the test stated in § 112(d) (the "if" clause) that was not incident to a reorganization. That assumption is true, in turn, only if the reference in the "if" clause to property "permitted by such paragraph [here, § 112(b)(4)] to be received without the recognition of gain" requires, as we contend that

it does, that some of the property received be in fact (not hypothetically) "stock or securities in * * * a party to a reorganization"—in short, that there be an actual reorganization.

If the test stated in § 112(d) in its application to § 112(b)(4)-type exchanges can be satisfied only if there is an actual reorganization—as § 112(d), in its statement of consequences, clearly assumes—then this must also be true of the test stated in § 112(c)(1) in its application to § 112(b)(3)-type exchanges, for the relevant language of both the underlying provision and of the "boot" provision is identical in both cases.[14] Section 112(d), therefore, directly confirms

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[14] Not only is the language identical, but the question of interpretation of § 112(d) could arise in circumstances precisely parallel to those of this case. Section 112(g)(1)(C) (which is parallel to § 112(g)(1)(B), the reorganization definition involved in this case) defines as a reorganization the acquisition by one corporation, in exchange "solely" for its voting stock, of substantially all the assets of another corporation (i.e., an assets, rather than a stock, acquisition, as is involved here). Suppose the *X* corporation, in a transaction that did not meet any of the other definitions of a reorganization, acquired all the assets of the *Y* corporation but gave in exchange both voting stock and cash. Notwithstanding the failure of the transaction (because of the cash) to qualify as a "C" reorganization, the *Y* corporation could claim that its exchange was taxable only to the extent of the cash received under § 112(d) on precisely the same argument that petitioner makes in this case—i.e., the transaction "would have been" a reorganization, and the exchange "would have been" within § 112(b)(4), if it were not for the cash. Thus petitioner's interpretation of the "if" clause would mean that a non-reorganization exchange could *qualify* under a provision (§ 112(d)) the stated *consequences* of which expressly assume the existence of a reorganization.

our interpretation of § 112(c)(1) as requiring an actual reorganization.[15]

V

THE UNDERLYING POLICY OF THE NONRECOGNITION PROVISIONS IS TO POSTPONE RECOGNITION OF GAIN ONLY IN EXCHANGES OF "LIKE-FOR-LIKE" AND STOCK IN ONE CORPORATION IS DEEMED "LIKE" STOCK IN ANOTHER ONLY WHEN THERE EXISTS BETWEEN THE TWO CORPORATIONS THAT CONTINUITY OF INTEREST THAT IS PRESCRIBED BY THE REORGANIZATION DEFINITIONS. THUS THE "LIKE-FOR-LIKE" POLICY PRECLUDES NONRECOGNITION WHERE THERE IS NO REORGANIZATION AND CONFIRMS THAT INTERPRETATION OF SECTION 112(C)(1)

In the preceding portions of this brief, we have shown that § 112(c)(1) is literally applicable only if some of the property received consists of "stock or securities in * * * a party to a reorganization" within the meaning of § 112(b)(3)—i.e., only if there is a "reorganization." In this Point we propose to show, in terms of the underlying policies, why it is that

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[15] Petitioner's attempt (Br. 17–19) to use § 112(d) in support of the opposite conclusion is untenable. The key to it seems to lie in the wholly false assumption that there could not be a true "reorganization" in which something besides "stock or securities * * * in a party to a reorganization" was received in exchange for the assets. A transaction in which "other property" was given could readily qualify as an "A" (statutory merger or consolidation) or a "D" (transfer to a controlled corporation) reorganization, and, for that matter, it cannot yet be said with certainty that there are no circumstances in which a transaction might qualify even as a "C" reorganization notwithstanding the receipt of *some* "other property". It may be noted, moreover, that § 112(d) retains the form it had before the reorganization definitions were so narrowly circumscribed, and any narrowing of the kinds of transactions to which it applies is the result of Congress' purposeful narrowing, for that very purpose, of the reorganization definitions themselves.

§ 112(c)(1) does preserve the "reorganization" requirement of § 112(b)(3).

There is in this case no disagreement about the underlying policy of the nonrecognition provisions. As stated by petitioner throughout his brief [16]—with which statements we are in full agreement [17]—the gist

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[16] "When the taxpayer has merely exchanged one thing for another of the same kind, in all practical effect he has just what he had before, merely in different form. The basic policy of the income tax structure, then, is to postpone taxation of the property received in kind until it should become the subject of some later taxable transaction, and to limit any immediate tax to the amount of any money or property other than in kind which the taxpayer receives in the exchange. This is the policy which runs throughout §§ 112 (a), (b), (c), (d) and (e)." (Br. 13.)

"* * * the legislative intent in the reorganization provisions is to permit * * * postponement of tax * * * when there is * * * 'mere change in the form of ownership.'" (Br. 14.)

"Congress was concerned [in the 1934 amendments adding the solely-for-voting-stock requirements to the "B" and "C" reorganization definitions] * * * with the tax-free receipt of stocks and securities by stockholders who had substantially changed their interest * * *." (Br. 22.)

"Congress intended as a broad policy to postpone tax effects as to *like-for-like* exchanges in a wide variety of transactions, considering it appropriate to delay the incidence of taxation until some profit or loss should actually be realized. At the same time, Congress provided for immediate taxation of 'boot' additions to like-for-like exchanges." (Br. 29.)

"Its [§ 112(c)(1)] essence is that in a like-for-like-plus-boot exchange, the tax effect as to the like-for-like is postponed while the tax effect as to the boot is immediate. * * *" (Br. 35.)

[17] Compare, for example, Treas. Regs. 118, § 39.112(a)-1(b): "* * * The underlying assumption of these exceptions is that the new property is substantially a continuation of the old investment still unliquidated; and, in the case of reorganizations, that the new enterprise, the new corporate structure, and the

of the policy is that an exchange of "like-for-like" or an exchange that leaves the taxpayer's interest "substantially unchanged" and reflects only a "mere change in the form of ownership" should not be a taxable event (except of course to the extent of any "boot" received), and recognition of the "paper profit" should be postponed until it is finally realized by conversion into a different kind of property.

In applying that policy, however, there must be a standard for determining when one interest is to be deemed "like" another. That standard is to be found, and can only be found, in the nonrecognition provisions themselves. Thus, business property is deemed to be "like" business property "of a like kind" (§ 112(b)(1)); common stock or preferred stock is deemed to be "like", respectively, common stock or preferred stock in the "same" corporation (§ 112 (b)(2)); transfer of property to a controlled corporation in exchange for stock in that corporation is deemed to be but a "mere change in the form of ownership" (§ 112(b)(5)); and a stockholder's interest is deemed to be "substantially unchanged" when it survives in the corporation emerging from insolvency proceedings (§ 112(l)). In precisely the same way, whether stock in one corporation is to be deemed "like" stock in another is governed by the definition of "likeness" in § 112(b)(3)—*to wit,* stocks in two different corporations are deemed to be "likes" only if the corporations are related to each other by being "parties to a reorganization."

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new property are substantially continuations of the old still unliquidated."

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The reason that the existence of a reorganization is made the test of "likeness" is, in turn, evident, for that is precisely what the reorganization definitions are there for: the very function of the reorganization definitions is to define the "continuity of interest" between two corporations which makes an exchange of their stock a "mere change in the form of ownership" with the nature of the stockholders' interests "remaining substantially unchanged." In terms of the reorganization definition relevant here (§ 112 (g)(1)(B)), Congress has said that the requisite "continuity of interest" between the corporate entities exists only when there is at least an 80% continuity in the equity ownership between the two corporations—i.e., only when at least 80% of the stockholders in the acquired corporation receive voting stock in the acquiring corporation, thereby continuing as equity owners (though through a new parent) in the same enterprise. If there is less than that required continuity of equity ownership, the transaction, so far as Congress is concerned, is deemed merely a sale and the corporations involved are deemed to have no more relationship to each other than any other two corporations.

In this case, less than 30% of the former equity ownership of Supply survived as an equity interest in Foremost, while over 70% was "bought out" for cash. In the congressional judgment, the withdrawal of so large a part of the equity interest from the enterprise destroyed any "continuity" between the two corporations and removed the very justification for treating the stock of the two corporations as like-kind

property. By the only standard of "likeness" that can be found in the Internal Revenue Code, therefore (and the standard expressly stated in § 112(b)(3)), the Supply stock and Foremost stock involved in this case were not, as petitioner asserts, "likes" but were, to the contrary, as "unlike" as the stock of any two corporations having no relationship to each other.

The reason, then, that § 112(c)(1) requires a reorganization is precisely because its "essence" *is*, as petitioner puts it (Br. 35):

> * * * that in a like-for-like-plus-boot exchange, the tax effect as to the like-for-like is postponed while the tax effect as to the boot is immediate. * * *

For whether the two corporations are parties "to a reorganization" is the very test of whether the stocks exchanged are deemed to be "like" each other. If there is no reorganization—i.e., if there is not the requisite "continuity of interest" between the two corporations to justify treating the exchange of securities as a "mere change in the form of ownership"—there simply does not exist a "like-for-like" element in the exchange. There is only an exchange of what are deemed to be "unlike" properties (stock in two unrelated corporations), which even petitioner concedes is fully taxable.

2. Viewed in terms of the underlying policies of the nonrecognition provisions, the speciousness of petitioner's claim that a hypothetical reorganization suffices to satisfy the "boot" provision becomes evident. It is true enough that, if petitioner had received no cash and only voting stock in Fore-

most, there would have been the continuity of equity ownership between the two corporations requisite to constitute a "reorganization" and to justify treating the stocks of each as substantial equivalents. In policy terms, however, "what might have been" has nothing to do with whether the stock petitioner actually received should be treated as "like" the stock he gave up—i.e., stock in two corporations between which there in fact exists no continuity of interest. What happened is decisive. So far as Congress has defined "likeness", petitioner in fact received property (the Foremost stock as well as the cash) entirely "unlike" the property he gave up. and the only applicable policy is that which requires full recognition of gain in an exchange of "unlikes" (§ 112(a)). Petitioner's hypothetical reorganization proves only that the exchange consisted of "like-for-unlike [but which would have been 'like' if the facts had been different]-plus-cash", and petitioner has yet to prove a policy of making tax-free an exchange of "unlikes hypothetically alike."

VI

PETITIONER'S INTERPRETATION OF THE NONRECOGNITION PROVISIONS IS INCONSISTENT WITH THE PROVISIONS GOVERNING THE ACQUIRING CORPORATION'S BASIS AND DEPRIVES THE SOLELY-FOR-VOTING-STOCK LIMITATION OF THE REORGANIZATION DEFINITION OF ANY MEANINGFUL FUNCTION

The argument in this brief has thus far been confined to the nonrecognition provisions themselves. In this Point we shall widen the discussion to show that petitioner's interpretation of those provisions cannot be reconciled with the related provisions of

the Code governing the "basis" of property acquired in stock-for-stock exchanges.

1. If a stockholder exchanges his stock in one corporation for stock in another (the "acquiring corporation"), it is true, as petitioner contends, that the *stockholder's* basis for his new stock will, under § 113(a)(6), be fixed consistently with his recognition or nonrecognition of gain on the exchange (to the extent that his gain is not recognized, his basis for the new stock will be the same as his basis for the old stock). What petitioner ignores, however, is the relationship between the stockholder's recognition of gain or loss and the basis to the *acquiring corporation* for the property acquired by it, and it is between those two consequences that the inconsistent results of petitioner's interpretation appear.

The basic rules governing the effect of such an exchange upon the acquiring corporation are these: If a corporation issues its own stock in exchange for stock of another corporation—or, for that matter, for money or any other kind of property—it realizes no gain upon that transaction whether or not there is a reorganization, since the transaction amounts simply to a stock subscription (Treas. Regs. 118, § 39.22(a)-15 (b)). Whether there is a reorganization is, however, important in determining its basis for tax purposes upon sale of the stock of the other corporation which it acquired. If no exception applies, its basis, under the general rule (§ 113(a)), is "cost," which is determined by the fair market value of the consideration (i.e., its own stock) given in exchange. If, however, a corporation acquires property "in connection with

a reorganization," then under § 113(a)(7) it is required to take the property with the same basis it had in the hands of the transferor (with appropriate adjustments for the gain or loss recognized by the transferor). Thus whether the acquiring corporation receives a "carryover" basis (equal to the transferor's basis) or a "stepped-up" basis (equal to fair market value[18]) depends entirely upon whether the transaction qualifies as a reorganization.

Since recognition or nonrecognition of gain by the transferor under §§ 112(b)(3) and (c)(1) also depends upon there being a reorganization—except of course for petitioner's claimed exception—it is evident that there is a close relationship between the nonrecognition of gain by the transferor and the carryover of basis to the acquiring corporation. That relationship, and the incongruous departure from it that would result from petitioner's interpretation of § 112(c)(1), can be shown by three examples, the first two of which are not, we believe, subject to dispute. In each case, it is assumed that *A* owns 81 of the 100 shares outstanding of the Old Corporation; that none of the other stockholders participate in the transaction; that *A*'s cost basis for the Old stock is $10 a share; and that the value of the stock of the New Corporation (all voting stock) is $100 a share:

Example 1: A exchanges 79 shares of Old stock for 79 shares of New stock. Since New Corporation acquired less than 80% of the Old stock, there is no re-

[18] Theoretically, this is the value of the stock given in exchange, rather than the value of the stock received, but the two will normally be the same.

organization. *A*'s gain of $90 a share (value of New stock, $100, less basis for Old stock, $10) is fully recognized (§ 112(a)).[19] New Corporation's basis for the Old stock is $100 a share ("cost," § 113(a), which is equal to the value of the New stock given in exchange). In brief:

(a) There is no reorganization.

(b) *A*'s gain is fully recognized.

(c) New Corporation receives a "stepped-up" basis.

Example 2: A exchanges all 81 shares of Old stock for 81 shares of New stock. Since New Corporation acquired more than 80% of the Old stock in exchange solely for its voting stock, there is a "B" reorganization. *A*'s exchange therefore qualifies under § 112(b)(3) and no gain is recognized. However, since New Corporation acquired the Old stock in a reorganization, it must, under § 113(a)(7), take over *A*'s $10-a-share basis for the stock, rather than a $100 "cost" basis. In brief:

(a) There is a reorganization.

(b) *A*'s gain is not recognized.

(c) New Corporation takes a "carryover" basis.

Example 3: A exchanges 81 shares of Old stock for 79 shares of New stock plus $200 in cash. Although New Corporation acquired more than 80% of the Old stock, there is no "B" reorganization because it did not do so in exchange "solely" for voting stock. In our view, the consequences would be precisely the

[19] Petitioner's "boot" argument would not apply, since the reason the transaction fails to qualify as a "B" reorganization is the failure to acquire 80% of the stock, not the presence of something other than voting stock.

same as in Example 1 (full recognition of gain; stepped-up basis) in which, though for a different reason, there was similarly no reorganization. Under petitioner's interpretation of § 112(c)(1), however, the gain would be recognized only to the extent of the cash—$200 in all, or about $2.50 per share for the 81 shares—notwithstanding the absence of an actual reorganization. Since the "carryover" basis provision (§ 113(a)(7)) applies only to actual, and not hypothetical, reorganizations, however, the New Corporation would still get a "stepped-up" basis ($100 per share) notwithstanding the almost total nonrecognition of gain by *A*. In brief, under petitioner's view:

(a) There is no reorganization.

(b) Only $2.50 of petitioner's $90 per-share gain is recognized.

(c) New Corporation receives a "stepped-up" basis.[20]

Those examples make clear, we think, the anomalous results of petitioner's argument. In every other context, qualification as a "reorganization" permits nonrecognition of gain but only at the price of the acquiring corporation's taking over the transferor's

[20] That is, stepped-up to the full $100 "cost" of the stock, and not simply by the amount of *A*'s recognized gain—i.e., from $10, *A*'s basis, to $12.50. It may be noted that if the exchange were in fact (instead of only "hypothetically") a reorganization, *A*'s recognized gain would be limited to the same amount as is claimed under petitioner's argument ($2.50), but with the additional consequence that New Corporation would have to take *A*'s basis in the Old stock ($10 a share) increased only by the amount of gain recognized by *A* ($2.50 a share) (§ 113(a)(7)).

low basis (Example 2), while failure to qualify as a "reorganization" permits the acquiring corporation to take a "stepped-up" basis but only at the price of the gain being fully recognized by the transferor (Example 1). In petitioner's view, however, the best of both worlds (nonrecognition of gain *and* a "stepped-up" basis) can be had if the acquiring corporation acquires enough stock to meet the 80% requirement of § 112(g)(1)(B) but takes care to pay cash for some of it in order to avoid meeting the solely-for-voting-stock requirement (Example 3). In such a case, there is no actual reorganization, so the acquiring corporation gets a stepped-up "cost" basis, but there is a hypothetical ("but for the cash") reorganization, so that, under petitioner's interpretation of § 112(c)(1), the gain is recognized to the transferor only to the extent of the cash. Such a transaction, in short, is to be treated "as though it were" a reorganization for purposes of the desirable consequences of reorganizations (nonrecognition of gain) but as in fact *not* a reorganization for purposes of the undesirable consequences (carryover of the low basis to the acquiring corporation).

The anomaly of the basis consequences of petitioner's argument is perhaps even more apparent in an assets-for-stock acquisition. Assume that the *X* Corporation, with fully-depreciated business assets, transfers all its assets to the *Y* Corporation in exchange mostly for voting stock but also enough for cash to prevent qualification as a "C" reorganization. There being no reorganization in fact, as required by § 113(a)(7), *Y* Corporation obtains a new "cost"

basis (measured by the cash plus the value of the *Y* stock it gave in exchange) for the assets, on which it is entitled to take depreciation. Under petitioner's view, however (which he acknowledges (Br. 18) is equally applicable to such a case), the *X* Corporation's gain would, under § 112(d), be recognized only to the extent of the nominal amount of cash received. Thus, by recognizing but a small fraction of the gain, the *X* Corporation would obtain the benefit (through its stock holdings in the *Y* Corporation) of a brand-new, full market value, basis for depreciation of its previously fully-depreciated assets.

That that result, divorcing the basis consequences from the recognition-of-gain consequences, defeats the policy of statute is evident, for precisely the same policy underlies the carryover-of-basis provision and the nonrecognition provisions. Nonrecognition of gain is allowed, as we have seen, on the theory that the receipt by the corporation that formerly owned the assets, of stock in the corporation that now owns them, results in a "mere change in the form of ownership" with the beneficial interests in the underlying enterprise continuing on "substantially unchanged." But it is for exactly the same reason that the acquiring corporation is required to take over the transferor's basis in the assets—with the same persons retaining a continuing interest "substantially unchanged" in the same enterprise, there is no justification for a change in the enterprise's depreciation basis. In short, if the transaction is not to be treated as a "sale" by the transferors, with a reckoning up of gain, it can hardly be treated as a "purchase" by the

transferee, with a new "cost" basis being created. Neeessarily, we submit, if the basis-carryover provision (§ 113(a)(7)) requires an actual reorganization—as it clearly does and as petitioner does not attempt to deny—the nonrecognition provisions cannot be interpreted to permit nonrecognition of gain without an actual reorganization. They are companion pieces in a complex fabric governing the several tax consequences of corporate reorganizations and acquisitions and must be interpreted consistently with each other.

2. A related point is that, since the basis and nonrecognition consequences discussed above are the *only* consequences of qualifying or not qualifying as a "B" reorganization,[21] petitioner's interpretation of the "boot" provision has the effect of depriving the solely-for-voting-stock limitation in § 112(g)(1)(B) of any rational purpose at all. If Congress had omitted

[21] In some types of transactions, such as assets acquisitions (e.g., "C" reorganizations), qualification as a reorganization may also be important in determining whether the acquiring corporation "inherits" from the transferor corporation certain "tax attributes" (earnings and profits, loss carryovers, etc.)—matters explicitly governed by § 381 of the 1954 Code (see Pet. Br. 2, 29) but left largely to judicial formulation under the 1939 Code. In a stock acquisition of the "B" type, however, the corporation as such survives (becoming a subsidiary of the acquiring corporation) and there is no question of transference of its tax attributes to another corporate entity. In such a transaction, therefore, the only consequences turning on the reorganization definition are (a) nonrecognition of gain to the transferor-stockholders under § 112(b)(3) and (c)(1); and (b) carryover of basis under § 113(a)(7) to the acquiring corporation. The limitations on the "B" definition have meaning, therefore, only insofar as they affect those two consequences of an exchange.

that requirement entirely from the definition of a "B" reorganization—and had instead simply limited nonrecognition under § 112(b)(3) to "voting stock" in the case of "B" reorganizations, with everything else being treated as "boot"—the result would have been precisely the same as that contended for by petitioner, with this single difference: the inconsistent basis consequence discussed above would have been avoided.[22] That is, if petitioner's interpretation of § 112(c)(1) is correct, then the only consequence of adding the solely-for-voting-stock limitation to the "B" definition was to create a tax loophole by giving a *preferred* status to transactions which *failed* to meet it (nonrecognition of gain without the resulting carry-over of basis required in all other "reorganization" exchanges). Not even petitioner, we believe, will argue that that was the intended purpose of the limitation (rather than, at best, an unintended by-product), and there is thus left no explanation at all for the addition of that limitation.

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[22] Since there would then be a "reorganization," § 113(a)(7) would require the acquiring corporation (here, Foremost) to take the transferor's (petitioner's) basis increased only by the gain actually recognized by the transferor—not, as is true under petitioner's contention, a stepped-up basis equal to the full market value of the stock.

VII

THE LEGISLATIVE HISTORY OF THE "BUT FOR" TEST OF THE "BOOT" PROVISION SHOWS THAT THE ADOPTION OF THAT LANGUAGE IN THE REVENUE ACT OF 1924 WAS NOT INTENDED TO EFFECT A SUBSTANTIVE CHANGE FROM THE DIFFERENTLY WORDED PROVISIONS OF THE REVENUE ACT OF 1921, UNDER WHICH IT WAS CLEAR THAT A REORGANIZATION WAS ESSENTIAL TO NONRECOGNITION OF GAIN

As petitioner repeatedly proclaims, his argument is based, not upon a claim that the transaction was actually a reorganization under § 112(g), but upon an interpretation of the "boot" provision, § 112(c)(1), as permitting nonrecognition in non-reorganization exchanges which "would have" qualified as reorganization exchanges "but for" the money received. Specifically, as we understand the argument, petitioner relies exclusively upon the hypothetical "but for" language of § 112(c)(1). The controlling legislative history, then, is not that of the reorganization definitions, but that of the "but for" language of § 112(c)(1). That history, we will show, reveals that the "but for" language was not in fact intended, and could not have been intended, to have the effect petitioner attributes to it.

1. The "boot" provision first appeared as § 202(c) of the Revenue Act of 1921, 42 Stat. 227. Petitioner refers to that provision as the "counterpart" of

§ 112(c)(1), and with that description we wholeheartedly agree. For the "boot" provision of the 1921 Act, although otherwise similar in function and purpose to § 112(c)(1), did *not* employ the "but for" language upon which petitioner's entire case depends. The history of the Revenue Act of 1924, in which the "but for" language was first adopted, shows, in turn, that that change in phraseology was not intended to effect a substantive change.

Section 202(c)(2) of the Revenue Act of 1921 was the forerunner of both § 112(b)(3) and § 112(g)(1) of the 1939 Code, the reorganization definitions at that time having been included in the nonrecognition provision itself. Section 202(e) was the "boot" provision from which § 112(c)(1) was ultimately derived. In relevant part those sections of the 1921 Act, as amended in a minor respect in 1923, provided:

> [§ 202(c)] * * * no gain or loss shall be recognized—* * * (2) When in the reorganization of one or more corporations a person receives in place of any stock or securities owned by him, stock or securities in a corporation a party to or resulting from such reorganization. The word "reorganization," as used in this paragraph, includes a merger or consolidation [*etc.*] * * *.
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> * * * * * *
>
> [§ 202(e)] * * * when property is exchanged for property specified in paragraphs (1), (2), and (3) of subdivision (c) as received in exchange, together with money or other property * * * other than that specified in such

> paragraphs, the [23] amount of the gain resulting from such exchange shall be computed in accordance with subdivisions (a) and (b) of this section, but in no case shall the taxable gain exceed the amount of the money and the fair market value of such other property received in exchange.

Since the crucial "but for" language is missing from those provisions, the elaborate argument petitioner has structured upon that language is inapplicable to them,[24] and they can be read in the straightforward

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[23] The remaining part of the sentence is set forth as amended by the Act of March 4, 1923, 42 Stat. 1560. Before that amendment it read:

"* * *, the money or the fair market value of such other property received in exchange shall be applied against and reduce the basis, provided in this section, of the property exchanged, and if in excess of such basis, shall be taxable to the extent of the excess."

That is the only change in the quoted provisions made by the 1923 amendment. The only effect of that amendment, it may be seen, was to change the method of accounting for the "boot": under the original 1921 Act, the "boot" was applied first in reduction of basis to the extent of the basis and only the excess treated as gain; under the 1923 amendment, the "boot" is treated first as gain to the extent of the gain, and only if the "boot" exceeds the gain is the excess applied in reduction of basis.

That change is irrelevant here, since we are concerned only with the test of qualification under the "boot" provision, and not with the method of accounting for the "boot" once it is determined to be applicable. Petitioner's reliance on the committee report on the 1923 amendment (Br. 20)—which simply explained the difference in the method of computation and was directed not at all to the kinds of exchanges to which the provision applied—is therefore entirely misplaced.

[24] That makes petitioner's reliance (Br. 20) on the history of the 1923 "accounting" amendment not only misplaced (see note 23, *supra*) but specious. The statute did not at the time

manner in which they are written. Section 202(c) provides that no gain or loss shall be recognized on the receipt, incident to a reorganization, of "stock or securities in a corporation a party to * * * [a] reorganization." Section 202(e) provides, in equally direct terms, that the gain will be recognized to the extent that any "other property" is received, with "other property" being doubly identified as property "other than that specified in" § 202(c)(2)—i.e., anything that is not "stock or securities in a corporation a party to * * * [a] reorganization." In short, under the 1921 Act, it was beyond dispute that there could be no nonrecognition of gain without a reorganization.

Petitioner's argument, therefore, requires him to show that a substantive change was effected by the Revenue Act of 1924, 43 Stat. 253, 257, in which both the nonrecognition provision (now, § 112(b)(3)) and the "boot" provision (now, § 112(c)(1) were given the form they have retained ever since. That Act, however, provides a different explanation for the change of language and the committee reports confirm that no substantive change was intended.

The 1924 Act effected a major cleaning-up and modernization of the rather haphazardly placed reorganization and nonrecognition provisions of the 1921 Act. For example, the nonrecognition provisions were separated from the basis provisions with which they had been joined; the reorganization definitions were placed in a subsection separate from the nonrecognition provisions; and the several nonrecognition

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of that amendment even include the language on which petitioner relies.

provisions were all rephrased in a unified style. Of particular relevance here is that in the rephrasing of all of the nonrecognition provisions (not simply what is now § 112(b)(3) but the provisions governing other kinds of exchanges as well) there was added the requirement, not present in the wording of the 1921 Act, that the property received consist "solely" of the specified kind. It is the addition of that requirement, we submit, that provides the complete explanation for the "but for" rephrasing of the "boot" provision.

Since the basic nonrecognition provisions of the 1921 Act (see, e.g., § 202(c)(2) quoted above, which was typical) were not limited to exchanges in which "solely" the described kind of property was received, they remained applicable notwithstanding the receipt of other property in addition to the specified kind, and it was therefore sufficient for the "boot" provision simply to prescribe directly the treatment to be given the "other property"—i.e., that the gain should be recognized to its extent. With the addition of the "solely" requirement, however, the receipt of any "other property" would be a total bar to qualification under the basic provisions. Hence it was no longer enough for the "boot" provision to say simply that the "other property" was taxable; it had also to give back what the "solely" requirement had taken away—i.e., by affirmatively according nonrecognition to the property that "would have" qualified under the basic provisions "but for" the "solely" requirement. In short, the addition of the "solely" requirement in the

predecessors of §§ 112(b) (1), (2), (3), and (5) [25] by itself made it essential that the "boot" provision, if it was to continue to perform the *same* function it had in the 1921 Act, be recast into its present form.

The committee reports accompanying the 1924 Act confirm that that was the sole reason for the change in the wording of the "boot" provision and that no substantive change in its effect was intended. Their only comments about the rewording of either what is now § 112(b)(3) (§ 203(b)(2) of the 1924 Act) or what is now § 112(c)(1) (§ 203(d)(1) of the 1924 Act) were as follows:

> [Section 203(b)(2)], together with section 203(h)1 [the section into which the reorganization definitions were put, now § 112(g)(1)], with the exception of minor changes in phraseology, is the same as section 202(c)2 of the existing law [the 1921 Act].
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> * * * * * *
>
> [Section 203(d)(1)] * * * corresponds to section 202(e) of the existing law * * *, and provides that where "boot" is given in connection with an exchange which would otherwise be tax free, the gain from the exchange shall be recognized, but in an amount not in excess of the amount of the money or other "boot." [26]

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[25] The "solely" requirement was also added to § 112(b)(4), but that is governed by a separate "boot" provision. See Point IV, *supra*.

[26] H. Rep. 179, 68th Cong., 1st Sess., pp. 1, 13, 14 (1939–1 Cum Bull. (pt. 2) 241, 251, 252); S. Rep. 398, 68th Cong., 1st Sess., pp. 1, 13, 14 (1939–1 Cum. Bull. (pt. 2) 266, 276, 277).

The change of wording in the 1924 Act is the only change that occurred in the nonrecognition and "boot" provisions between §§ 202(c)(2) and (e) of the 1921 Act and §§ 112(b)(3) and (c)(1) of the 1939 Code, and there has been no further congressional comment on those provisions. If, then, a reorganization was essential to nonrecognition under the 1921 Act (as it indisputably was), and no substantive change was intended by the rewording of the 1924 Act (as clearly none was), the foundation for the castle petitioner has built upon the "but for" language adopted in 1924 is destroyed. The "boot" provision today means precisely the same thing it did in 1921: if some of the property received is the kind described in the basic provision (not hypothetically but in fact) and some is not, the former is tax-free and the latter is not.

2. We may add that not only was the "but for" language of the 1924 Act not in fact intended to extend nonrecognition to hypothetical reorganizations, but it could not have been so intended. The reason is that, as reorganizations were defined in that Act, there was at that time no way to make such a use of the "but for" language. Section 203(h)(1) of the 1924 Act defined a reorganization as follows:

> The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all of the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if

> immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

It may be seen that none of those definitions prescribed, in terms, any limitation on the kind of consideration that might be received. A failure to qualify as a "reorganization" could not, therefore, be specifically attributed to the receipt of some particular kind of property, and hence there was no way to say that "but for" a particular receipt there "would have been" a reorganization.[27] Thus, petitioner's argument attributes to the "but for" language adopted in 1924 a purpose that it could not possibly have had at the time it was adopted.

It was not, it should be noted, until the Revenue Act of 1934, 48 Stat. 680, ten years after the "but for" language was adopted, that the specific solely-for-voting-stock limitation was added to what are now

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[27] It is true that the "continuity of interest" test judicially developed to confine those definitions to transactions fitting their spirit as well as their letter had the practical effect of limiting the kinds of property that might be received in exchange, say, for "substantially all" a corporation's assets. See, e.g., *LeTulle* v. *Scofield*, 308 U.S. 415, 418; *Pinellas Ice & Storage Co.* v. *Commissioner*, 287 U.S. 462; *Helvering* v. *Minnesota Tea Co.*, 296 U.S. 378; *Cortland Specialty Co.* v. *Commissioner*, 60 F. 2d 937 (C.A. 2). Surely, however, petitioner will not claim that his purportedly "literal" but-for theory is so flexible that it permits a recipient to assume away simply whatever undefined part of the receipts would be sufficient to restructure the transaction in such a way that the imprecise "continuity of interest" standard would be met.

the "B" and "C" reorganization definitions, and it is only with that specific limitation that petitioner's argument, even in his own terms, becomes applicable. And to say that Congress in adopting the "but for" language in 1924 intended to create a "potential" method of qualifying hypothetical reorganizations for nonrecognition which it "completed" ten years later is to suggest, to say the least, a unique form of two-step legislation. Rather, the only purpose the "but for" language could have had in 1924 was to alleviate the "solely" requirement concurrently added to the nonrecognition provisions. Its purpose in 1924 could not have been to alleviate the "reorganization" requirement, and, with no intervening change in the statute, that purpose cannot be attributed to it now.[28]

3. In the light of what seems to us the conclusiveness of the history of the "boot" provision itself—the provision upon which petitioner's argument directly

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[28] The same analysis is true of the provision originating as § 203(f) of the 1924 Act (now § 112(e)). That provision is a companion to § 112(c)(1) and the test of qualification is the same. The only difference is that turning on whether the exchange results in a gain or a loss: § 112(c)(1) makes the gain recognizable to the extent of the "boot", while § 112(e) provides that the presence of "boot" will not affect the nonrecognition of loss.

The quotation from the committee report on § 203(f) of the 1924 Act on which petitioner relies (Br. 21) is, on its face, addressed solely to the question of the effect on loss-recognition of a failure to meet the "solely" requirement of the nonrecognition provisions themselves—i.e., a case in which some of the property received is of the kind described in those provisions and some is not. It is not, and could not be, addressed to a failure to quality as a reorganization because property other than voting stock was received, since, as pointed out in the text, the solely-for-voting-stock requirement was not yet in existence.

rests—we need not examine in detail the history of the revised "reorganization" definitions adopted in the Revenue Act of 1934, in which the solely-for-voting-stock requirement first appeared. To the extent that it is relevant, that history is sufficiently set forth in the opinion of the court of appeals (R. 58–61). And in answer to petitioner's misuse of that history, it is sufficient to point out that everything said in connection with the 1934 Act about the desirability of allowing nonrecognition of gain, preventing the recognition of losses, or providing equality of treatment in states in which statutory mergers or consolidations were unavailable, was addressed to a single question—what transactions should be defined as reorganizations. Every consequence or objective mentioned was thought to be a consequence of qualifying or not qualifying *as a reorganization,* and there is nothing in that history to suggest that anything turns upon "what might have been" a reorganization. Thus, even petitioner's assertion that Congress was primarily concerned in the 1934 Act with preventing recognition of "paper losses" proves the opposite of his point. For the 1934 Act dealt *only* with the reorganization definitions, and it must be, therefore, that Congress thought its objects, whatever they were, could be achieved simply by varying the reorganization definitions as such. And that is true only if, as we contend and *contrary* to petitioner's contention, qualification or nonqualification as a reorganization is the touchstone upon which recognition or nonrecognition of loss directly depends. Petitioner, in short, can hardly rely on what Congress sought to achieve

by defining reorganizations in support of an argument that there can be nonrecognition of gain without a reorganization.

In fact, of course, what Congress sought to achieve by adding the solely-for-voting-stock requirement for a "B" or "C" reorganization was a stricter continuity-of-interest test (see *Helvering* v. *Southwest Corp.*, 315 U.S. 194, 198). The very purpose of the continuity-of-interest test is, in turn, to say when there is such a successorship between two corporations as to justify treating exchanged interests in them as a "mere change in the form of ownership" not justifying the imposition of a tax—i.e., to say when gain should or should not be recognized. And that is precisely the consequence of the solely-for-voting-stock limitation that petitioner's argument would deny.

VIII

THE REGULATIONS PERMIT NONRECOGNITION IN STOCK-FOR-STOCK EXCHANGES ONLY IF THERE IS A REORGANIZATION

1. The regulations under the "boot" provision (Treas. Regs. 118, § 39.112(c)–1(c), hereafter cited only by section number) refer, for the treatment of "boot" in reorganization exchanges, to the following provision:

> SEC. 39.112(g)–4. *Exchanges in reorganization for stock or securities and other property or money.* (a) If in an exchange of stock or securities in a corporation a party to a reorganization, in pursuance of the plan of reorganization, for stock or securities in the same corporation or in another corporation a party to the reorganization, there is received by the

> taxpayer other property (not permitted to be received without the recognition of gain) or money, then
>
> (1) As provided in section 112(c)(1), the gain, if any, to the taxpayer will be recognized in an amount not in excess of the sum of money and the fair market value of the other property * * *.

That regulation, it may be seen, is a restatement of § 112(b)(3) and § 112(c)(1) read together. It puts them together in such a way, however, as to eliminate the "but for" reference and make clear that the "boot" provision applies to such exchanges only when some "stock or securities in a corporation a party to a reorganization" are in fact received but some "other property" is also received. If valid, therefore, that regulation controls this case, where no "stock or securities in a corporation a party to a reorganization" were in fact received.[29]

2. Equally explicit is § 39.112(g)-1(c) which provides in part:

> The nonrecognition of gain or loss is prescribed for two specifically described types of [reorganization] exchanges, viz: The exchange that is provided for in section 112(b)(3) * * * [and] in section 112(b)(4) * * *. Certain rules respecting boot received in either of the two types of exchanges * * * are prescribed in sections 112(c) and 112(d). * * * The provisions of the Internal Revenue Code referred to in this paragraph are inapplicable unless there is a plan of reorganization. * * *

[29] What the Tax Court found in that regulation to support the opposite result (R. 40-41) is not clear.

That again interprets § 112(c)(1), the "boot" provision, as being limited, as it applies to § 112(b)(3)-type exchanges (i.e., stock-for-stock), to exchanges incident to actual, not hypothetical, reorganizations.[20]

3. In addition to those explicit provisions, there runs throughout the regulations the underlying assumption that, in the area of stock-for-stock exchanges, "reorganization" and "nonrecognition of gain" are but different aspects of the same thing. Thus, for example, the statement that the "underlying assumption of these exceptions [to recognition of gain] is * * *, in the case of reorganizations, that the new enterprise, the new corporate structure, and the new property are substantially continuations of the old still unliquidated" (§ 39.112(a)-1(b)) seems implicitly to equate nonrecognition with the existence of a reorganization. The same is true of the statement that "The purpose of the reorganization provisions * * * is to except from the general rule [of recognition of gain] certain specifically described exchanges incident to such readjustments of corporate structures, made in one of the particular ways specified in the Code [i.e., by the reorganization definitions], as are required by business exigencies, and

[20] Petitioner objects to that regulation on the ground that § 112(c)(1) also applies to other types of exchanges which do not involve reorganizations, e.g., § 112(b)(1)-type exchanges (Br. 33). Of course it does, but it is equally plain that the regulation is speaking only of the interaction of § 112(c)(1) with § 112(b)(3), not with the various other nonrecognition provisions. It is only that interaction that is involved here, and as to that the meaning of the regulation is plain.

which effect only a readjustment of continuing interests in property under modified corporate forms" (§ 39.112,(g)–1(b)). The same implication is present also, for a final example, in the statement, following a description of the "specifications of the reorganization provisions," that "Both the terms of the specifications and their underlying assumptions and purposes must be satisfied in order to entitle the taxpayer to the benefit of the exception from the general rule," the "general rule" being that requiring gain to be recognized (*ibid.*).

CONCLUSION

For the reasons stated, the judgment below should be affirmed.

Respectfully submitted.

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OCTOBER 1961.

APPENDIX

INTERNAL REVENUE CODE OF 1939
(26 U.S.C., 1952 ed.)

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges Solely in Kind.*—

(1) *Property held for productive use or investment.*—No gain or loss shall be recognized if property held for productive use in trade or business or for investment (not including stock in trade or other property held primarily for sale, nor stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest) is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment.

(2) *Stock for stock of same corporation.*—No gain or loss shall be recognized if common stock in a corporation is exchanged solely for common stock in the same corporation, or if preferred stock in a corporation is exchanged solely for preferred stock in the same corporation.

(3) *Stock for stock on reorganization.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(4) *Same—gain of corporation.*—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(5) *Transfer to corporation controlled by transferor.*—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange. * * *

* * * * *

(10)[1] *Gain or loss not recognized on reorganization of corporations in certain receivership and bankruptcy proceedings.*—No gain or loss shall be recognized if property of a corporation (other than a railroad corporation, as defined in section 77m of the National Bankruptcy Act, as amended) is transferred, in a taxable year of such corporation beginning after December 31, 1933, in pursuance of an order of the court having jurisdiction of such corporation—

(A) in a receivership, foreclosure, or similar proceeding, or

(B) in a proceeding under section 77B or Chapter X of the National Bankruptcy Act, as amended,

to another corporation organized or made use of to effectuate a plan of reorganization ap-

[1] This provision and § 112(l), *infra*, and all references to them in the other provisions, were added by the Revenue Act of 1943, § 121, 58 Stat. 21.

proved by the court in such proceeding, in exchange solely for stock or securities in such other corporation.

* * * * *

(c) *Gain from Exchanges Not Solely in Kind.*—

(1) If an exchange would be within the provisions of subsection (b)(1), (2), (3), or (5), or within the provisions of subsection (l), of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph or by subsection (l) to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) If a distribution made in pursuance of a plan of reorganization is within the provisions of paragraph (1) of this subsection but has the effect of the distribution of a taxable dividend, then there shall be taxed as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be taxed as a gain from the exchange of property.

(d) *Same—Gain of Corporation.*—If an exchange would be within the provisions of subsection (b)(4) or (10) of this section if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the

corporation shall be recognized from the exchange, but

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

(e) *Loss from Exchanges Not Solely in Kind.*—If an exchange would be within the provisions of subsection (b)(1) to (5), inclusive, or (10), or within the provisions of subsection (l), of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized.

* * * * *

(g) *Definition of Reorganization.*—As used in this section (other than subsection (b)(10) and subsection (l)) and in section 113 (other than subsection (a)(22))—

(1) The term "reorganization" means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation, or (C) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of substantially all the properties of another corporation, but in determining whether the exchange is solely for voting stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall

be disregarded, or (D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its shareholders or both are in control of the corporation to which the assets are transferred, or (E) a recapitalization, or (F) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another.

* * * * *

(l) *Exchanges by Security Holders in Connection with Certain Corporate Reorganizations.*—

(1) *General rule.*—No gain or loss shall be recognized upon an exchange consisting of the relinquishment or extinguishment of stock or securities in a corporation the plan of reorganization of which is approved by the court in a proceeding described in subsection (b)(10), in consideration of the acquisition solely of stock or securities in a corporation organized or made use of to effectuate such plan of reorganization.

* * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS—(a) *Basis (unadjusted) of Property.*

The basis of property shall be the cost of such property; except that—

* * * * *

(6) *Tax-free exchanges generally.*

If the property was acquired, after February 28, 1913, upon an exchange described in section 112(b) to (e), inclusive, or section 112(l), the basis * * * shall be the same as in the case of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount

of gain or decreased in the amount of loss to the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made. If the property so acquired consisted in part of the type of property permitted by section 112(b) or section 112(l) to be received without the recognition of gain or loss, and in part of other property, the basis provided in this paragraph shall be allocated between the properties (other than money) received * * *.

(7) *Transfers to corporation.*

If the property was acquired—

* * * * *

(B) in a taxable year beginning after December 31, 1935, by a corporation in connection with a reorganization,

then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transfer.

* * * * *

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REPLY BRIEF FOR PETITIONER

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In the Supreme Court of the United States

October Term, 1961

No. 60

George B. Trumbo and Boyd H. Trumbo,
Petitioners,

v.

Commissioner of Internal Revenue,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

REPLY BRIEF OF PETITIONERS

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In the Supreme Court
OF THE
United States

October Term, 1961

No. 60

Grover D. Turnbow and Ruth H. Turnbow,
Petitioners,

vs.

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Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

REPLY BRIEF OF PETITIONERS

The Commissioner's brief is no answer to the case; it omits all consideration of the legislative purpose and the effect of the "boot" provisions in their relation to the nonrecognition (i.e., tax deferment) provisions of the Internal Revenue Code, and it studiously avoids all consideration of the effect of its argument on the correlative "loss" provision (§ 112(e)) of the Code. When these matters are considered, the unsoundness of the Commissioner's reasoning stands out in sharp focus.

FIRST: THE COMMISSIONER'S INTERPRETATION OF § 112(c)(1), ADMITTING AS HE DOES THAT THE TEST UNDER THAT SECTION AND UNDER § 112(e) IS THE SAME, WOULD OPEN UP A LARGE TAX LOOPHOLE UNDER § 112(e) (NOW § 356(c) OF THE 1954 CODE).

In attempting to close the door on tax deferment as to the voting stock component of a voting-stock-for-voting-stock corporate acquisition despite current full taxation of gain to the extent of any accompanying boot, the Commissioner has opened wide another door to a method of converting paper losses into tax losses under § 112(e) of the 1939 Code (now § 356(c) of the Internal Revenue Code of 1954) (Petr.Br. 15-17, and Appx. ii and iv). The Commissioner's brief does not dispute that the similar language of §§ 112(c)(1) and (e) must be similarly read and applied (*Davies Warehouse Co. v. Bowles* (1944) 321 U.S. 144, 150; *Howard v. Commissioner of Internal Revenue* (7 Cir. 1956) 238 F.2d 943; Petr.Br. 15). In fact, his brief notes in passing that the test or qualification is the same under both §§ 112(c) and (e) (Resp.Br. 63, note 28).

The Commissioner does not discuss the effect of this new apparent loophole, nor does he discover to the Court any evidence of or reason supporting any supposed Congressional intent or purpose in that direction.

Following the Commissioner's theory: If a stockholder whose stock had largely *depreciated* in value should exchange it (as part of not less than 80% of the voting stock of the corporation) for voting stock of another corporation pursuant to a plan of reorganization, he could of course not claim a tax loss since § 112(b)(3) specifically provides that no loss shall be recognized in that situation. But if he should arrange to receive in addition a

dollar in cash, then: § 112(b)(3) would not apply because the exchange was not "solely" for stock or securities; the transaction would no longer "qualify" as a "reorganization"; therefore the "but for" hypothesis in § 112(e) could not apply and that section would not preclude recognition of loss; hence under the basic statute, § 112(a), the taxpayer could take the entire paper loss as a tax loss.

The court in the *Howard* case (*Howard v. Commissioner of Internal Revenue* (7 Cir. 1956) 238 F.2d 943)) agreed that such a result was never within the language or the intent of § 112(e). The pertinent committee reports emphasize the Congressional purpose to prevent the taking of tax losses when the taxpayer retains a continuing interest in merely changed form (quotations, Petr. Br. 15-16, 21-22, 25). If the Commissioner's interpretation should now prevail and this handy tax-loss device be opened up, the effect could be serious indeed.

Though these matters were presented in our opening brief, the Commissioner has not suggested any answer. But he does not escape the problem by looking the other way. The force of this element alone—the effect of the Commissioner's argument on the correlative loss provision—is itself, we respectfully submit, so cogent as to compel rejection of the Commissioner's reading of the statutes.

SECOND: THE COMMISSIONER'S BRIEF IGNORES THE INCONSISTENCY OF HIS INTERPRETATION WITH CONGRESS'S DEMONSTRATED (AND ADMITTED) TAX POLICIES AND PURPOSES. THE TAXPAYER'S POSITION, ON THE CONTRARY, EFFECTUATES THE CONGRESSIONAL POLICIES AND CARRIES OUT THE LEGISLATIVE PATTERN.

The fundamental Congressional policies are clear. On the one hand, Congress intended in general to tax immediately the gain resulting from sales or exchanges (§ 112(a)); on the other hand it recognized and expressed a policy not to impede or discourage business readjustments which went rather to the form of the taxpayer's property interest than to the substance (*Seiberling Rubber Co. v. Commissioner of Internal Revenue* (6 Cir. 1948) 169 F.2d 595, 597; *Commissioner of Internal Revenue v. Gilmore's Estate* (3 Cir. 1942) 130 F.2d 791, 794). By postponing taxation[1] until some more pronounced change of position should occur, desirable business flexibility could be preserved while losing none of the prospect of taxing the profit when and as ultimately realized.

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[1]One fact must always be remembered: While much has been said about "tax-free" exchanges under the nonrecognition provisions, they are not tax free, but the tax is merely deferred until some profit is actually realized. Nonrecognition does not impute any escape from taxation (Magill: Taxable Income, Revised Edition, 1945, p. 144; and authorities cited in our opening brief, page 13).

Nor does §112 (e)(1) make gains tax free, or even necessarily defer *any* taxes. If the amount of the boot equals or exceeds the amount of the gain, the entire gain is taxed immediately. It is only when part of the gain resides in the voting stock received, that Congress limits the amount of recognized gain to the amount of the boot.

Turnbow does not escape taxation; he has paid his full taxes on his gain to the extent of the cash boot, and taxation of any ultimate profit on the stock received is inchoate and will become consummate whenever he sells the stock.

The question is merely one of recognizing and applying the expressed purpose of Congress in the timing of the taxes.

The tax-deferred, like-for-like category is not unlimited, of course. It does not include an exchange of Standard Oil stock for General Motors stock, for example, though both may be industrial common stocks. Moreover, Congress has changed or narrowed the category at times. But within the category as set forth by Congress from time to time are the exchanges which Congress has determined to merit this tax-deferred flexibility.

Where for business reasons some cash or other property (in addition to the like-for-like property) must be added to the consideration, § 112(c)(1) effectuates both policies by preserving the tax deferment as to the like-for-like property while immediately taxing any gain to the extent of the cash or other boot.

The Commissioner is "in full agreement" that such are the underlying Congressional policies (Resp.Br. 42-43), but signally avoids any effort to reconcile his interpretation of § 112(c)(1) with them. This avoidance is understandable, since his position is irreconcilable with the full and eminently practical satisfaction of both policies.

The taxpayer's position effectuates both legislative policies. Deferment of taxation to the extent of the value of the stock received recognizes that Turnbow's equity interest in the Supply enterprise continues in the form of his equity interest in Foremost, of which Supply continues in business as an operating subsidiary—a typical form of corporate reorganization. At the same time, he has paid all taxes on his gain to the full extent of the added cash.

The Commissioner admits (Resp.Br. 45-46) that if Turnbow had received only Foremost voting stock and no

cash, the stock components would be like-for-like and the requisite continuity of interest would obtain. But, he argues, if *any* cash is added, the continuity of interest residing in the exchange of stock disappears entirely, and even the stock elements are no longer like-for-like and the corporations have become strangers (Resp. Br. 45). This, we respectfully submit, does not make either good tax sense (the gain to the full extent of the cash is immediately taxable) or good economic sense. Some amount of cash may have to be added to the consideration—or part of the consideration for one from among many stockholders—for any one of a score of economic reasons. The stockholder-taxpayer's continuity of interest *so far as the voting stock is concerned* remains whether some stockholder received an added dollar or not.[2]

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[2]The amount or percentage of cash added, so long as there is voting-stock participation in the new corporation in exchange for voting-stock participation in the old, is a false quantity so far as this problem is concerned. The percentage of interest itself can vary widely without destroying continuity. For example, a sole owner of a small corporation making a solely stock-for-stock exchange with a large corporation may wind up with only a 10% or 1% equity ownership in the large corporation (and through it, in the small corporation of which he formerly owned 100%), but the continuity of interest requirement is fully satisfied. If he receives in addition a dollar in cash, *the equity percentages remain exactly the same.* The percentages depend strictly upon (1) the percentage of the total voting stock transferred on the one hand (not less than 80%), and (2) the percentage of the total voting stock received on the other hand (any percentage). So, if Turnbow received 82,000 out of a total of 100,000 shares of Foremost, his equity ownership in Foremost (and through Foremost, in Supply) would end up at 82%, while if he received 82,000 out of a total of 1,000,000 shares of Foremost, his equity ownership in Foremost (and Supply) would end up at 8.2%—*both regardless of the amount of added cash which he might receive.* The Commissioner's sudden switch from consideration of the 80% minimum requirement on the one side to discussion of the 30-70 stock-

The Commissioner's inconsistency with admitted legislative policy stands out in sharp relief on comparing B-type reorganizations with mergers. In 1934 Congress determined that exchanges of at least 80% of the voting stock of one corporation solely for voting stock of another, or of substantially all the assets of one corporation solely for voting stock of another, represented sufficient continuity of interest to receive the same treatment as mergers or consolidations, and that such treatment was necessary in order not to have stockholders in some states suffer discrimination as compared with those in other states where such transactions would fit the local requirements of statutory mergers or consolidations (S. Rept. 558, 73d Cong., 2d Sess., 16-17 (C.B. 1939-1, Pt. 2, pp. 598-599, quoted, Petr. Br. 23). But Congress did not then change § 112(c)(1), which covered the tax treatment of boot. In mergers, the tax laws had long provided for tax deferment to the extent of like-for-like stock, and taxation of gain to the extent of boot if the exchange included money or other property. If in a state where the transaction would not qualify as a statutory merger a stockholder could not demand an extra dollar in cash and still be accorded tax deferment on any paper gain as far as the stock was concerned, while in another state a stockholder in a similar transaction would be accorded such treatment simply because

---

cash ratio on the other side (Resp. Br. 44) must be read cautiously, for it leaps to a false issue.

It is to be ever remembered (1) that any gain is always currently taxable to the extent of the cash, and (2) that these various percentages can just as readily occur in a statutory merger or consolidation, with no different effect as to continuity of interest, tax deferment as to the stock, and current taxation of gain to the extent of the cash.

the transaction would meet the local statutory requirements of a merger, the objective of Congress to prevent such discrimination would pro tanto be defeated.

The necessity for such parity of tax treatment, and its harmony with the over-all legislative policies, clearly appear in the not uncommon situation presented in the *Howard* case, supra (238 F.2d 943). There, basically, was a B-type (voting-stock-for-voting-stock) reorganization, but some of the minority stockholders demanded cash—certainly not an uncommon situation. The court held the boot provision (§ 112(c)) applicable, thus satisfying all policies—deferring the tax to the extent of the like-for-like part of the transaction and limiting immediate taxation of gain to the amount of cash received.

Howard, we submit, is correct. It truly reflects the interrelation and fullest application of the Congressional purposes and policies and the statutes themselves.[3]

In net result, the Commissioner is arguing (as the court below held) that the boot provisions, while fully operative with respect to A-, D-, E- and F-type reorganizations, disappear from the legislative pattern when boot is added to what are basically (and but for the boot would be *wholly* tax deferred as) B- and C-type reorganizations. Elimination of B- and C-type reorganizations from the

---

[3]The Commissioner's statement that the *Howard* decision "has been universally criticized" by tax commentators (Resp.Br. 19) is not accurate, as a reading of the cited comments readily reveals. A number of the "critical" comments were based on the startling and obviously erroneous premise that *Howard* decided that a B-type reorganization can include cash boot—e.g., Donnelly, Kanter, and 73 Harv.L.Rev. 1402 (Resp.Br. 19, note 4). By contrast, the note in 43 Va.L.Rev. 436 correctly analyzes the decision and suggests that it was logical and correct.

scope of the well-established legislative pattern would effect a deviation from the natural operation of demonstrated legislative policy with no discernible hint from Congress as to why this should be.

In the end, the Commissioner doubts his own argument. He is not sure but that a B- or C-type reorganization may qualify as such despite the inclusion of other property or money, and that the result reached by *Howard* is arguably correct (Resp.Br. 21, note 7; and again at page 41, note 15).

THIRD: THE COMMISSIONER'S INTERPRETATION OF § 112(c)(1) IS LOGICALLY AND GRAMMATICALLY FALLACIOUS. THE TAXPAYER'S READING IS LOGICALLY AND GRAMMATICALLY SOUND.

The essence of the Commissioner's contention is that from the reference in § 112(c)(1) to "property permitted, etc." it follows that Congress intended to write in a requirement that all prerequisites to nonrecognition must first be satisfied as to that property, having in mind the existence of boot as part of the exchange; then and only then can the "if not" supposition be applied—too late to accomplish hypothetical elimination of the boot.

Let us analyze this reasoning. Suppose one says: "If this creature would be a man if it were not for the fact that he has not only the characteristics of a male human being but also horns and a forked tail, he is a devil." The Commissioner's reasoning would be: "But this creature does have horns and a forked tail, which are not characteristics of a male human being; therefore the hypothesis does not apply, and he is not a devil." Such

reasoning is an obvious perversion of the plain intent of the supposititious sentence. Yet it is precisely the Commissioner's method in the present case.

Looking closely at the Commissioner's step-by-step reasoning reveals the precise point of fallacy. He says (Resp.Br. 17) "§ 112(c)(1) first divides the property received into two categories • • • and then provides that, if the exchange *'would be'* [our italics] within § 112(b)(3) if [etc.] • • • If that is a proper reading, the provision cannot apply unless *some* of the property received *in fact belongs* [our italics] to the first category." The switch is evident. The Commissioner has started from the statutory *contrary-to-fact* subjunctive, and restated it as *in-fact* present indicative. Here is the basic non sequitur, the precise point at which the Commissioner misreads the statutory language.

Logically and grammatically, the statute presents a contrary picture. Section 112(c)(1) in using the words "If an exchange would be • • • if it were not for" depicts a hypothesis contrary to fact. The presence of the cash *in fact* (in what otherwise would be B- and C-type reorganizations) spoils "solely for stock or securities" in § 112(b)(3) and "solely for • • • voting stock" as imported into § 112(b)(3) from § 112(g)(1)(B). The Commissioner says the "if not" supposition applies readily enough to restore (hypothetically) the first "solely," but then stops applying, short of restoring (hypothetically) the second "solely" and hence "reorganization." Nothing in the statute hints at this artificial demarcation.

Natural understanding of the language is all to the contrary. Congress first (§ 112(b)) described the exchange

transactions for which it provided total tax deferment. Then it considered in §§ 112(c)(1), (d) and (e) the same exchanges with other property or money added. There was no need to spell out once again all the specific exchanges plus boot. Instead, Congress used the simple device of a blanket reference to the kind of property as to which tax would be deferred, plus the supposition of other property or money added to it. The test which Congress set up by the "if not" clause was simply: "Absent the money or other property, would the remaining exchange be within the provisions for total tax deferment?"

This natural interpretation the Tax Court and its predecessor the Board of Tax Appeals have followed for many years without any division of opinion. Thus in the case at bar, the Tax Court, after noting the requirements of § 112(b)(3), including "solely," went on to say (R. 38-39):

> "Both of the sections involved here, subsection (b)(3) and subsection (c)(1), are provisions of long standing which were reenacted in the successive revenue acts which preceded the 1939 Code. In both the regulations of the Commissioner and in this Court's interpretation of section 112(c)(1), it has been understood that in order to give effect to the provisions of section 112(c)(1) the method to be followed is first to omit the item of cash (or other property) from the transaction and then to determine whether the exchange would be within subsection (b)(3). Otherwise, section 112(c)(1) would have no meaning in the context of its references to particular subsections of section 112(b).
>
> In Luther Bonham, 33 B.T.A. 1100, 1103-4 (1936), this Court concluded that the method of applying the statute was as follows:

> • • • It is necessary therefore to determine whether or not the exchange of • • • stock for • • • stock would be within the provisions of subsection (b)(3) if the item of cash had been omitted and only • • • stock had been received in exchange for • • • stock. (Underscoring supplied.)"

The court then went on to quote from *Howard*, supra (which reversed the Tax Court on a point not reached by the latter), as follows:

> "Thus we may conclude that, in determining when these so-called 'boot' provisions apply, Congress intended that the transaction is to be considered separately and apart from the 'boot' received in determining whether it meets the nonrecognition provisions. If the transaction, absent from the 'other property or money,' fulfills the requirements of section 112(b)(3), then gain is to be recognized to the extent that 'boot' is received."

The Tax Court in the case at bar simply reiterated its understanding of many years as to the method of applying § 112(c)(1). In *Elizabeth Bruce* (1934) 30 B.T.A. 80 (later reversed on other grounds), and in *R. C. Love* (1939) 39 B.T.A. 172, the Board applied the method. In *Luther Bonham* (1936) 33 B.T.A. 1100, supra, the Board explained the application of § 112(c)(1) as plainly as words can express:

> "Giving careful consideration to the meaning of the term 'reorganization' quoted above from the statute and the facts in this case *after omitting from consideration, in accordance with the provisions of subsection (c) (1), the cash payment* received by the stockholders of the bank, we can find nothing of sub-

> stance which would distinguish this case from that of *Commissioner v. Watts*, 296 U. S. 387. Under authority of that decision, we accordingly hold that *but for the fact that cash was received* in the instant transaction, the exchange would be within subsection (b) (3) of section 112, *supra*, and under subsection (c) (1) of the same section the gain to the petitioner may not be recognized in an amount in excess of $67,500 [the amount of cash received]" (emphasis added).

Such was the Tax Court's reading of § 112(c)(1) for many years. Congress in 1934 did not change a word of § 112(c)(1), nor did it have occasion to in order to preserve its long-standing pattern of limited recognition of gain in boot situations.

This interpretative method of the Tax Court, repeated by unanimous decision over so long a period of years, is entitled to more than passing honor. This Court has observed that the Tax Court is an expert body, especially familiar with the interpretation and application of tax statutes, their background and legislative history, and the impact of its decisions upon both Treasury and taxpayer (*Dobson v. Commissioner* (1943) 320 U.S. 489, 498-502).

The 1934 amendment of the definition sections had no bearing upon this method of applying § 112(c)(1). What the amendment did was to tighten in certain particulars the definition of properties which the taxpayer could exchange without any recognition of gain (or loss) at the time. It did so by increasing to 80% the minimum stock to be transferred, and by excluding from nonrecognition securities other than voting stock through the addition of "solely." But it did not touch the boot provision, of

which the "if not" language was clearly understood to have the effect of overcoming the "solely" in § 112(b)(3) and in all natural contemplation would have the effect of following through and overcoming the effect of the "solely" now imported into § 112(b)(3) in its reference to "reorganization." The contention that Congress had something else in contemplation—though it left the boot provision just as it was—is unnatural, strained, and does not commend itself as a reasonable interpretation of the mind of Congress.

Section 112(c)(1) itself does not mention "reorganization." The reference to "reorganization" in the taxing statute is in § 112(b)(3), the description of what exchange of property can be made without any recognition of gain. When Congress changed "reorganization", it changed the category of property which can be exchanged without any recognition of gain; but it changed nothing about the boot provision, which continued to operate as before, taxing immediately the gain to the extent of all other components of the exchange.

In consequence of his unnatural approach, the Commissioner falls into sophistry. E.g., Brief for the Respondent, pages 29 et seq., where the Commissioner reasons, from the premise that §§ 112(b)(3) and (c)(1) apply only to individual exchanges, that any assumption permitted by § 112(c)(1) must be limited to an assumption about what was received by the single recipient in the particular exchange in issue. From this the Commissioner hypothesizes situations with absurd consequences, culminating in the Never-Never-Land of footnote 12 on page 32—as a final result of which he comes full-circle to the conclu-

sion that the assumption under § 112(c)(1) is not limited to what is received by the particular taxpayer but must take into account what is received in all the exchanges pursuant to the common plan.

The answer to all this is quite simple. If Turnbow, sole stockholder, receives only voting stock in the acquiring corporation, the exchange is exclusively like-for-like, the tax-deferment principle applies to the whole, and § 112(c)(1) does not come into the picture. If Turnbow, sole stockholder, receives voting stock plus cash, the exchange is partly like-for-like (to which the tax-deferment principle applies) and partly boot (to which immediate taxation of any gain applies). If there are multiple stockholders exchanging their stock pursuant to a common plan, stockholder X who receives only stock has all tax deferred, stockholder Y who receives stock plus cash pays taxes currently on any gain to the extent of the cash only, and stockholder Z who holds out for all cash pays taxes currently on his entire gain. The same result would obtain in a statutory merger. *Howard* is in accord.

The Commissioner's theory of reasoning from the premise that §§ 112(b)(3) and (c)(1) *apply* only to individual exchanges, that hence their applicability must be tested upon the particular exchange in issue (Resp.Br. 29), leads to obviously unintended consequences. For example, two stockholders each owning 40 per cent of the voting stock of a corporation to be acquired, together can make up the required 80 per cent. If they exchange their stock for voting stock of the acquiring corporation, there is a B-type reorganization. But if, in testing the applicability of § 112(b)(3) to one of the stockholders, we

must look only at the components of *his* exchange, then § 112(b)(3) cannot apply because that exchange involved only 40 per cent, not 80 per cent, of the voting stock of the acquired corporation and no tax deferment would result.

This illustrates that in determining the tax consequences to the individual, tax deferment and/or current taxation accompany, respectively, the stock and/or money or other property which *he* receives; but in determining the application of the deferment provisions (§§ 112(b)(3) and 112(c)(1)) to the corporate transaction in general, the entire transaction pursuant to the plan is the focal point. This presents no problem of either interpretation or administration; it accords with the declared intent of Congress; and it gives rise to none of the peculiar consequences envisioned by the Commissioner at pages 30-32 of his brief.

FOURTH: GIVING FULL CONSIDERATION TO ALL OF THE LEGISLATIVE HISTORY RELIED UPON, THE HISTORY FULLY SUPPORTS THE TAXPAYER'S LITERAL READING AND APPLICATION OF THE STATUTE.

Nowhere does the Commissioner's failure to regard the basic purposes and intent of Congress stand out more significantly than in his review of the legislative changes from 1921 to 1934 (Resp.Br. 55-65). He argues, in essence, that the addition of the "but for" language in 1924 made no substantive change, and could not have anticipated the narrowing of the reorganization definitions in 1934. But consider what Congress was trying to accomplish under the various acts and how it did so:

In 1921, when the stockholder-taxpayer in one of these corporate re-formations (merger, consolidation, reorganization) received stock or securities, no gain was recognized; when he received in addition money or other property, even though gain resulted he could apply the money to reduce his tax basis and defer his taxes to that extent (Revenue Act of 1921, § 202(c), 42 Stat. 230).

In 1923, if the stockholder-taxpayer received only stock or securities, again no gain was recognized; if he received in addition money or other property, his gain was currently taxed to the extent of the money or other property (removing the privilege of applying this to reduce his tax basis instead) (Act of March 4, 1923, 42 Stat. 1560).

In 1924, when Congress wrote "solely" into § 112(b)(3) (total tax deferment) § 112(c)(1) was reworded to preserve the pattern. The hypothetical form of § 112(c)(1) served to remove the exclusionary effect of "solely" in § 112(b)(3). Congress still deferred taxes as to the stock or securities, and currently taxed the gain to the extent of any money or other property (Revenue Act of 1924, § 203(d)(1), 43 Stat. 257).

By 1934, Congress was disturbed by the fact that taxpayers under existing law were able to exchange common stock (an equity interest) in one corporation for, say, callable preferred stock (easily convertible to cash) or even a predominant amount of debentures (a creditor interest, almost the equivalent of cash) in another corporation and obtain tax deferment, since these were "securities" within § 112(b)(3). (If any cash were added, of course the boot provision took care of that by exclud-

ing it from nonrecognition of gain.) Such exchanges, Congress felt, were not sufficiently like-for-like exchanges —not sufficiently reflecting a continuity of interest—to merit treatment apart from the immediate taxation of gain in ordinary exchanges; i.e., they were really tax avoidance schemes having no economic justification. Congress set about eliminating them. But there was no concern and no reason for any concern over tax avoidance as to cash boot; § 112(c)(1) took care of that with current taxation of any gain to the extent of the boot received.

The House recommended withdrawing tax deferment from B- and C-type reorganizations entirely (H.Rept. 704, 73d Cong., 2d Sess., 12-14 (C.B. 1939-1, Pt. 2, 563-565)); but the Senate (and the Congress finally) decided that this would unduly interfere with legitimate business adjustments, and that changing the "stock or securities" requirement to "voting stock" and lifting the minimum of exchanged stock from a bare majority to 80 per cent would reinforce the continuity-of-interest factor and prevent the tax avoidance schemes.[4] *But Congress did not touch or even mention § 112(c)(1),[5] and the "other property or money" feature was no part of its concern about tax avoidance because any gain to that extent was always currently taxable since 1923.* What Congress did was to define more narrowly the like-for-like element as to which taxation was to remain on a deferred basis, but it had no occasion to, and did not, bother about the tax treatment of boot added to the like-for-like property.

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[4]S.Rept. 558, 73d Cong., 2d Sess., 16-17 (C.B. 1939-1, Pt. 2, 598-599), quoted in our opening brief, pages 23, 25.

[5]Congress was not unmindful of § 112(c) in 1934; it made a technical amendment of § 112(c)(2) (48 Stat. 704).

Congress had experienced the manner in which § 112(c)(1) hypothetically removed the exclusionary effect of "solely" in § 112(b)(3). So when Congress inserted "solely" in § 112(g)(1)(B)—incorporated by reference into § 112(b)(3)—it was only natural to expect that § 112(c)(1) would continue to take care of boot-added situations by hypothetically removing the effect of "solely" throughout.[6] Far more readily is this to be expected than that Congress would think it was covertly removing two ordinary types of corporate re-formations from the scope of the well-known boot-added pattern without mention of the fact, contrary to its expressed purpose of interstate uniformity with mergers and consolidations, and particularly when so doing would correspondingly remove them from the purview of § 112(e) and create a wide-open loophole for turning paper losses into tax losses, which Congress had worked so purposefully to avoid.

This is where the Commissioner's brief neglects the significant piece of legislative history which proclaims a purpose diametrically opposed to his theory. In rejecting the House's recommendation to drop B- and C-type reorganizations from the definitions in 1934, the Senate Committee report which accompanied the legislation in its final form stated that exchanges of 80 per cent of the voting stock on the one hand solely for voting stock on the other were sufficiently similar to statutory mergers and

[6]It is of interest that the Conference Committee Report (H. Rept. 1385, 73d Cong., 2d Sess., 21-22 (C.B. 1939-1, Pt. 2, 632)) discussed the amendment of § 112(g)(1) in the language of "all or part of the voting stock" without even mentioning "solely." The word could not have been thought to make a significant change in the existing tax pattern.

consolidations as to be entitled to similar tax treatment, and should be permitted "in order to bring about a more uniform application of the provisions in all 48 of the States."[7] Whereas in statutory mergers and consolidations, cash could be (and frequently is) added to the stock consideration, and tax deferment applies to the extent of the value of the stock received while gain to the extent of the cash is immediately taxed, uniformity will not follow if in another state an identical transaction not constituting a statutory merger under local law receives not even partial tax deferment. The positive intention of Congress to provide for equal and uniform tax treatment confirms the literal reading of § 112(c)(1) and belies the Commissioner's distortion of it.

Likewise, the Commissioner's brief neglects the committee report accompanying the Hendler amendment in 1939 (quoted, Petr.Br. 25-26), which provides, in effect: If under the specifically defined circumstances, the taxpayer transfers property and receives in exchange stock or securities in a corporation which is a party to the reorganization, nonrecognition of the entire gain is allowed; but if other property or money is added, gain is recognized to the extent of such other property or money.

In another aspect, the Commissioner's theory does even more obvious violence to the legislative history. This is with respect to § 112(e), dealing with losses. It is undenied that § 112(e) and its predecessors were enacted for the express purpose of preventing loss-taking through the device of inserting some cash or other property into what

[7] S.Rept. 558, 73d Cong., 2d Sess., 16-17, supra (C.B. 1939-1, Pt. 2, pp. 598-599), quoted in our opening brief, page 23.

was basically an exchange of like-for-like interests.[8] But, now says the Commissioner in effect, in 1934 Congress intended by amending §§ 112(g)(1)(B) and (C) to remove these classes of transactions from the application of the "if not" language in the boot provisions, with the consequence of opening up a large loophole for the taking of tax losses through the same simple device. Not only did Congress give no hint that such was its desire; on the contrary, the committee reports at the time are filled with expressions of Congressional purpose to eliminate the taking of the losses while the taxpayers retain an interest in the corporation.[9]

The taxpayer's reading of the statutes accords with the expressed legislative purposes; the Commissioner's reading is at war with them.

FIFTH: THE COMMISSIONER'S ARGUMENT REGARDING "BASIS" IS UNSOUND; TAX TIMING AND BASIS ARE NOT INTERDEPENDENT. EVEN A QUALIFYING REORGANIZATION CAN RECEIVE A STEPPED-UP BASIS.

The Commissioner's thesis here is that a "carryover" basis for the acquiring corporation must exist only where nonrecognition of gain (tax deferment) to the stockholder exists (Resp.Br. 53). Such, however, is not the law and

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[8]The legislative history in this connection is reviewed in the *Howard* case, with particular reference to the explanatory committee report (quoted in our opening brief, pages 15-16).

[9]Both the House (H.Rept. 704, 73d Cong., 2d Sess., 12-14, C.B. 1939-1, Pt. 2, 563-565) and the Senate (S.Rept. 558, 73d Cong., 2d Sess., 17, C.B. 1939-1, Pt. 2, 599, quoted in our opening brief, page 25) acted on committee reports strongly recording a purpose to prevent such loss-taking.

the Commissioner has so conceded. In *Firestone Tire & Rubber Co.* (1943) 2 T.C. 827, the Tax Court held that in a qualified B-type reorganization where the acquiring corporation utilized its treasury shares in the exchange, it would receive a stepped-up basis—i.e., the cost of its treasury shares—despite the fact that any gain to the stockholder would admittedly not be recognized and tax deferment would result as to him. The Commissioner first indicated nonacquiescence (C.B. 1944, 38), then dismissed his appeal and registered acquiescence with the Tax Court's decision (C.B. 1945, 3). This was acquiescence that recognition of gain to the stockholders is not wedded to the corporation's basis, despite the Commissioner's present argument to the contrary.

The Commissioner's "related point" (Resp.Br. 53) is likewise unsound. Our interpretation, he argues, would deprive the solely-for-voting-stock limitation in § 112(g)-(1)(B) of any rational purpose at all. On the contrary, the solely-for-voting-stock limitation had a direct, obvious and wholly rational effect on § 112(b)(3); where previously total nonrecognition could follow an exchange of nonvoting stock, the narrower definition of a B-type reorganization precluded that effect. The Commissioner admits (Resp.Br. 54) that if Congress had not put the limitation into § 112(g)(1)(B), it would have had to do something with § 112(b)(3) to achieve its purpose; and this would have been considerably more awkward in view of the more general application of § 112(b)(3).

SIXTH: THE REGULATIONS SUPPORT THE TAX COURT'S INTERPRETATION, NOT THAT PRESENTLY ADVOCATED BY THE COMMISSIONER.

The Tax Court in the case at bar pointed out (R. 40-41) that the regulations remained unchanged throughout the long period during which the Tax Court continuously interpreted § 112(c)(1) as requiring first the hypothetical omission of the boot from the transaction and thereupon the testing of the transaction without boot against the requirements of § 112(b)(3). Without change, the regulations followed and accepted the *Bonham* decision from 1936 on. As the Tax Court said (R. 41):

> "Thus, there has been a long-standing and continuous construction of section 112(c)(1) (and the corresponding section in the earlier revenue acts) which has remained unchanged over the years in the face of the several reenactments of the statutory provision, as well as the amendment in the 1934 Act of section 112(g)(1)(B), when there was introduced into subsection (g)(1)(B) the word, 'solely,' in harmony with the provisions of subsections (b)(2), (b)(3), (b)(4), and (b)(5) which also contained the word, 'solely,' and contained 'solely' for many years. The respondent's regulations, therefore, are deemed to have received the approval of Congress. Helvering v. Winmill, 305 U.S. 79; Lykes v. United States, 343 U.S. 118. Respondent has not offered any explanation for his departure in this case from his long-standing interpretation of section 112(c)(1) set forth in his regulations."

Failure to change the regulations while the Tax Court was continuously interpreting § 112(c)(1) as it did is strong indication that the regulations accorded with the

Tax Court's view—as the Tax Court itself found (R. 41-42).

The Commissioner's brief does not refer to all of the applicable regulations.[10] It omits all reference to the basic regulation dealing with the receipt of boot: Regulations 118, § 39.112(c)-1 (quoted in our opening brief, Appx. viii-ix), which provides:

> "§ 39.112(c)-1 *Receipt of other property or money in tax-free exchange not connected with corporate reorganization.* (a) If in any transaction in which property held for investment or productive use in trade or business is exchanged for property of like kind to be held either for productive use or for investment; • • • [certain specific provisions inapplicable here] • • • there is received by the taxpayer other property (in addition to property permitted to be received without recognition of gain) or money, then
>
> (1) The gain, if any, to the taxpayer will be recognized in an amount not in excess of the sum of the money and the fair market value of the other property, but
>
> (2) The loss, if any, to the taxpayer from such an exchange is not to be recognized to any extent (see section 112 (e))."

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[10]He quotes a part of a section dealing with a specific situation (Resp.Br. 65-66) saying:

> "That regulation, it may be seen, is a restatement of § 112 (b)(3) and § 112(c)(1) read together. It puts them together in such a way, however, as to eliminate the 'but for' reference . . . ."

Though appropriate to the specific situation which it described, this regulation cannot "eliminate" the "but for" reference in the statute wherever that is applicable. Any regulation which conflicts with the plain words of the statute of Congress is invalid (*Helvering v. Sabine Trans. Co.* (1943) 318 U.S. 306, 311-312).

The basic regulation repeats the fundamental tax pattern and by its terms covers the transaction at bar. It was not changed throughout the period of the Tax Court's "long-standing and continuous construction of section 112(c)(1)." The Tax Court's determination that the method of applying § 112(c)(1) is in accord with the Commissioner's long-standing regulations is correct.

CONCLUSION

There is no merit, either logical, economic or historical, in the contentions advanced in the Commissioner's brief. We respectfully submit that the judgment of the court below should be reversed.

Dated: San Francisco, California,
November 9, 1961.

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